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In The

Supreme Court of the United States

GREEN TREE FINANCIAL CORP. – ALABAMA AND GREEN TREE FINANCIAL CORPORATION,

Petitioners,

v.

LARKETTA RANDOLPH,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Eleventh Circuit

AMICUS CURIAE BRIEF OF NATIONAL ASSOCIATION OF CONSUMER ADVOCATES IN SUPPORT OF RESPONDENT

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STATEMENT OF INTEREST OF AMICUS[1]

The National Association of Consumer Advocates ("NACA") is a non-profit organization of private and public sector attorneys, legal services attorneys, and law professors concerned with the protection and representation of consumers. NACA's mission is to promote justice for all consumers. NACA maintains a forum for information sharing among consumer advocates across the country and serves as a voice in the ongoing struggle to curb unfair and abusive business practices.

NACA long has been concerned about the imposition by businesses of mandatory, pre-dispute arbitration clauses on their customers. The expense and the inherent limitations on discovery, injunctive relief, and appellate review which characterize arbitration materially disadvantage consumers, particularly for relatively small individual claims. Consistent with its goal of promoting justice for consumers, NACA has appeared as *amicus curiae* in a number of cases challenging mandatory predispute arbitration clauses, including *Badie v. Bank of America*, 79 Cal. Rptr. 273 (1998), *rehearing denied* Dec. 2, 1998, *rev. denied*, 1999 Cal. LEXIS 1198, and other cases involving attempts by financial institutions to obtain an advantage over consumers by unilaterally selecting a forum which does not enable consumers to enforce their statutory rights. NACA has also drafted a Position Paper, identifying frequent abuse by institutional interests of

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[1] This brief is filed with the consent of all parties, and letters of consent have been filed with the Clerk. No counsel for any party authored the brief in whole or in part, and no person or entity other than *amicus curiae* made any monetary contribution to the preparation or submission of the brief.

mandatory binding arbitration and the consequent denial to consumers of access to the courts and to justice, a copy of which is attached at Appendix (App.) 1.

SUMMARY OF ARGUMENT

Legitimate arbitration, according to the Court's jurisprudence, simply substitutes one fair forum for another. *See Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628, 634 (1985). As recognized by the Court of Appeals below, the present case does not involve legitimate arbitration. It involves instead an attempt by a well-financed and powerful business enterprise, supported by scores of institutional interests, to gain an unfair and deceptive dispute resolution advantage over individual consumers. This type of "arbitration" is not the type of alternative dispute resolution envisioned by Congress when it enacted the Federal Arbitration Act in 1925, 9 U.S.C. §§ 1-16 ("FAA"). Nor is it the type of arbitration the Court has deemed subject to the federal policy favoring enforcement of consensual arbitration clauses.

NACA urges the Court to adopt an objective, federal standard to guide courts, businesses, consumers and arbitral providers as the minimum standard required before an arbitration clause may be considered legitimate and therefore subject to the federal policy favoring enforcement of consensual arbitration. NACA submits that a legitimate arbitration clause must meet the following three-part test:

1. The clause must not materially shift the economic costs or risks of dispute resolution onto a party who would not otherwise bear

those costs or risks before a formal judicial forum;

2. The clause must not deprive one party of substantive rights or remedies or permit a party to obtain possession of the personal or real property subject to the dispute outside of the arbitration process; and
3. The clause must identify the manner in which the arbitration proceeding is to be commenced.

NACA submits that each of the many arbitration clauses this Court has confronted under the FAA has met these minimum standards. The clause involved in the present case, however, violates each one of these standards and should be held to be illegitimate under the FAA.

As we demonstrate below, and as the Court of Appeals correctly held, petitioner's clause dramatically shifts the economic costs and risks of dispute resolution away from the party who drafted the clause and onto the party forced to proceed in arbitration. In addition, petitioner's clause permits petitioner to take possession of the property subject to the arbitration dispute by means of a separate judicial or nonjudicial foreclosure proceeding wholly outside of the arbitration process and before the arbitration has even concluded. In this way, petitioner may obtain such an overwhelming economic and tactical advantage that the arbitration becomes a meaningless charade. Even more striking is the utter failure of petitioner's clause to provide any indication of how the alternative dispute mechanism is to be commenced. While the FAA may fill some gaps by enabling a federal court to appoint an arbitrator where an arbitration clause is silent

on the subject, it cannot fill that gap here. Oddly, petitioner's clause specifies that petitioner shall choose the arbitrator, but it totally fails to provide fair notice and an opportunity to be heard. The clause is, in reality, nothing more than a tricky drafting device designed to smother all disputes and squelch even legitimate claims.

ARGUMENT

I. GREEN TREE'S ARBITRATION CLAUSE IS DESIGNED TO SQUELCH DISPUTES, NOT RESOLVE THEM.

As conceived and implemented by the consumer financial services industry, arbitration of consumer disputes does not simply involve an alternative forum, as this Court envisioned in *Mitsubishi*. Instead, arbitration of disputes between consumers and financial institutions is intended to, and does in operation, significantly disadvantage consumers. One of the primary proponents of arbitration, Alan S. Kaplinsky, counsel for *amici* American Bankers Association, American Financial Services Association, Consumer Bankers Association, and National Home Equity Mortgage Association, candidly admits that:

> Arbitration materially changes the dispute resolution rules that consumers and borrowers are accustomed to: there is no right to a jury trial, pre-hearing discovery is limited, class actions are eliminated and appeals are severely circumscribed.

Alan S. Kaplinsky, *Anatomy Of An Arbitration Clause: Drafting and Implementation Issues Which Should Be*

Considered By A Consumer Lender, 1113 PLI/Corp. 655, 657 (1999).

Adoption of arbitration in the consumer financial services context has been portrayed as a defense against consumers. "Consumers have been ganging up on banks. But now the institutions have found a way to defend themselves." Alan S. Kaplinsky & Mark J. Levin, *Excuse me, but who's the Predator? Banker's side*, ABA Bus. L. Today 24 (May/June 1998) ("*Predator*"). This defense shifts the costs on to consumers, eliminates the consumers' right to a jury trial, and results in markedly reduced liability for business. *See, e.g.*, Patricia Sturdevant & Dwight Golann, *Face Off: Should Binding Arbitration Clauses Be Prohibited In Consumer Contracts?* Desp. Resol. Mag., Summer 1994, at 5 (App. 5); Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 Wash. U. L.Q. 637, 684 (1996) ("*Panacea*").

Arbitration was first adopted in the consumer financial services arena by ITT Consumer Financial Services Corporation in 1989. ITT had been sued for packing unwanted insurance into consumer loans by governmental and private attorneys in fourteen different jurisdictions and had lost or settled most of those cases for substantial sums of money. ITT admitted that it had committed many improper practices in a consent judgment with the Arizona Attorney General, settled a case by the California Attorney General for more than $50 million, and was facing claims in another case in Minnesota for an additional $48 million. Dwight Golann, *Consumer Litigation In The Age Of Combat Banking*, 45 Bus. Law. 1761, 1762-67 (1990).

In response, ITT inserted an arbitration clause into its standardized form small loan contracts, and hired Equilaw, Inc., the parent corporation of the National Arbitration Forum ("NAF"), to provide a mechanism for resolving claims by consumer borrowers across the country.[2]

A few years later, in 1992, Bank of America became the first major financial institution to insert arbitration clauses into its accounts with retail customers. Michael Z. Green, *Preempting Justice Through Binding Arbitration of Future Disputes: Mere Adhesion Contracts Or A Trap For The Unwary Consumer?* Loyola Consumer Law Reporter, 112, 115 (1993). The bank adopted arbitration as a response to a series of major judgments and settlements adverse to California banks, including a $5.2 million jury verdict for excessive late and overlimit fees on credit card accounts which was upheld on appeal,[3] and a $55 million settlement by several major banks of a price fixing case challenging the interest rates on credit cards. Dwight Golann, *Consumer Financial Services Litigation: Major Judgments And ADR Response*, ABA, The Business Lawyer, May, 1993. The bank publicly admitted it had chosen arbitration to avoid unpredictably high damage awards by juries. Press release dated June 2, 1992 (App. 14).

A contemporaneous study on the introduction of private, binding arbitration in the banking industry by The Rand Institute for Civil Justice confirmed that private

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[2] ITT's arbitration clause was held to be unconscionable in *Patterson v. ITT Consumer Financial Services Corporation*, 14 Cal. App. 4th 1659 (1993), *cert. denied*, 510 U.S. 1176 (1994).

[3] *Beasley v. Wells Fargo Bank, N.A.*, 235 Cal. App. 3d 1383, 1407 (1991), *review denied*, No. S0244, 1992 Cal. LEXIS 1220 (Cal. Mar. 12, 1992).

arbitration mechanisms were adopted to reduce the institutions' exposure to liability by limiting the risk of punitive damages and large jury verdicts, and thereby reducing the incentives for plaintiffs' attorneys to take cases. *See* Erik Moller, Elizabeth Rolph, and Patricia Ebener, *Private Dispute Resolution in the Banking Industry* 6-8, 12-13, 32 (1993) ("The Rand Study"). Lenders have acknowledged elsewhere that the motivating factors triggering the inclusion of arbitration requirements for consumer disputes was the fear of exposure to lender liability lawsuits and punitive damage verdicts. Lloyd N. Shields, *The Role of Mandatory Arbitration for Financial Institutions*, Arb. J., Dec. 1991, at 49.

The facts therefore fully support the observation of one eminent commentator that the adoption of arbitration clauses was "a carefully planned strategy by influential members of the financial services industry to resolve lender liability and other claims made by consumers as a group." Mark E. Budnitz, *Arbitration Of Disputes Between Consumers And Financial Institutions: A Serious Threat To Consumer Protection*, Ohio State Journal On Dispute Resolution, Vol. 10, No. 2, 367, 369 (1995). Indeed, as industry counsel have admitted, consumer financial services companies have implemented arbitration programs to gain an economic and litigation advantage over consumers. Alan S. Kaplinsky & Mark J. Levin, *Alternative To Litigation Attracting Consumer Financial Services Companies*, Consumer Financial Services Law Report, 1102 PLI/Corp. 845, 847 (1999). Thus, the simple but unpleasant fact is that arbitration is marketed as a way to avoid the costs and risks of the court system.

Some providers of arbitration services even offer preferential treatment as an inducement to financial institutions to utilize their services. For example, at Appendix 27 is a letter dated October 20, 1997 from Edward Anderson of NAF ("The Anderson Letter")[4] stating that: "major American companies are moving all of their contracts to an arbitration basis as fast as possible. There is no reason for your clients to be exposed to the costs and risks of the jury system." The Anderson Letter emphasizes that: "Every award is **limited to the amount claimed!**" (emphasis in original). A "Legal Memorandum" from "Forum Counsel" on the subject of "Arbitration & Class Actions in Financing" is attached to the Anderson Letter (App. 28). The memorandum advises that: "In the court system, financing transactions are always at risk for Class Action treatment. . . . " It further states that: "Most often, the claims of class action plaintiffs' lawyers are based on printed or computer-generated documents or standard procedure manuals, which leave little room to argue against 'commonality' and 'typicality.' " The memorandum then boasts that rules drafted in the manner of the NAF's will preclude class actions, even if the plaintiffs'

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[4] Documents taken from the 1994 Bankruptcy Petition of NAF's corporate parent, Equilaw, Inc., (App. At 33), indicate that Mr. Anderson was then a director, officer, and major shareholder of Equilaw. A deposition of Mr. Anderson taken in 1994 indicates that prior to coming to NAF, he was Assistant General Counsel to ITT Consumer Financial Services Corporation, (Anderson Deposition Excerpt, App. at 38), and that he learned of NAF when ITT was searching for an ADR provider (App. at 39).

claims are "common" and "typical." Thus, NAF has effectively marketed its arbitration service not as an alternative forum, but as a defensive measure to squelch consumer disputes.

It is clear therefore that the purpose and intent of mandatory arbitration clauses in financial institutions' standardized form contracts is to limit institutional liability and change the rules by which disputes are resolved to the detriment of their customers. The unilateral imposition of arbitration for such purposes provides an altered, rather than an alternative forum, and finds no support in sound public policy or in the FAA or its legislative history.[5]

Arbitration clauses undoubtedly deter consumers from challenging business practices which legislatures have specified are unlawful, deceptive, or unfair. The 1993 Rand Study found that after Bank of America unilaterally adopted mandatory arbitration, substantially fewer consumers brought claims against the bank. Moller *et al., Private Dispute Resolution in the Banking Industry,* at 21-23.

Arbitration in consumer cases does not provide an alternate forum; it sets up a more favorable private forum for institutions. Robert Raven, when he was President of the American Bar Association, warned that "certain forms of private judging dispense with many of the most cherished and carefully developed features of our public system: open proceedings, written decisions, appellate

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[5] The Brief *Amicus Curiae* filed by Public Citizen sets forth the legislative history of the FAA and demonstrates that the Act was intended only to validate consensual agreements between business entities to arbitrate their differences without altering the substantive rights of either party.

review, and the evolution of the common law." Robert D. Raven, *Private Judging: A Challenge to Public Justice*, 74 A.B.A. J. 8 (Sept. 1, 1988). President Raven further observed: "the potential dangers of providing one system of justice for the affluent, and another for everyone else, should stimulate us all to improve our system of public justice. This 200-year-old system with vital safeguards cannot simply be replaced by private judging." *Id.* Those cherished features of public adjudication are not present in arbitration.

A. Arbitration Has Not Proved To Be Less Expensive Than Litigation.

The claim by Green Tree's *amici* that arbitration is beneficial to consumers because it is less expensive (Br. *Amici Curiae* of American Bankers, *et al.*, at 4, 14-15) reflects an initial expectation, or myth, that is devoid of support in reality. Because providers of arbitration services such as the American Arbitration Association impose filing fees which far exceed the fees charged by courts, and in addition charge administrative, processing, and hearing fees, and because the parties must pay for the time of the arbitrator, while judges and courts are publicly funded, arbitration is inordinately expensive, and may be far more costly than litigation. Patricia Sturdevant, *Mandatory Arbitration and Access To Justice*, Association of Business Trial Lawyers (ABTL) Report, Vol. 3, No. 1, 12 (November, 1993).

Few studies have been conducted to determine the costs of arbitration and even those have produced mixed results. Scholars from the Rand Institute for Civil Justice have explored the question in the greatest detail. The Institute's Deborah R. Hensler concludes that the answer

to the question whether ADR programs actually reduce costs for litigants is still largely unknown. Deborah R. Hensler, *Does ADR Really Save Money? The Jury's Still Out*, Nat'l Law J., April 11, 1994, at C2 (App. 40). Another study of private alternative dispute resolution in Los Angeles indicates that fees charged in arbitration "usually greatly exceed those levied by the courts." Elizabeth Rolph, Erik Moller, Laura Peterson, *Escaping The Courthouse*, Rand Institute for Civil Justice 1, 44 (1994). The study notes that "the fees charged for private ADR services can be large" and then summarizes fee structures for the major private ADR firms. Those firms charge hearing fees for the arbitrator in the range of $550 a day to $450 a hour for each party, and also charge administrative fees, transcript fees, reporters' costs, travel expenses, and conference room costs. *Id.* at 40-43.

Thus, it simply has not been demonstrated that arbitration is cheaper than litigation. *See* Sternlight, *Panacea, supra*, at 678-79. Nor has it been shown that arbitration is faster than litigation. Another commentator notes that there is little strong data supporting the theory that ADR saves significant time and money for participants in the system. Lucy C. Katz, *Compulsory Alternative Dispute Resolution and Voluntarism: Two-Headed Monster or Two Sides of the Coin?*, 1993 J. Disp. Resol. 1, 46 (*"Two-Headed Monster"*). The myth that arbitration is cheaper is not supported by any real basis in fact, and the Eleventh Circuit's concern about the steep costs of arbitration here were well founded.

B. The Severe Limit On Discovery In Arbitration Favors Business Interests.

The limits on discovery in arbitration often make it impossible for consumers to prove the business engaged in unlawful activity. The FAA provides for only a very limited type of discovery by permitting arbitrators to order that witnesses may bring documents to the hearing. 9 U.S.C. § 7 (1982). Most arbitration providers similarly limit discovery to what an arbitrator, in his discretion, may order. Commentators agree that arbitration substantially reduces the amount of permissible discovery. Budnitz, *supra*, at 271; Edward Brunet, *Questioning The Quality Of Alternative Dispute Resolution*, 62 Tul. L. Rev. 1, 13 (1987); Kaplinsky & Levin, *Alternative, supra*, at 847. But just and fair results of any dispute resolution process require mechanisms that ensure full disclosure of the facts. Disputes simply cannot be decided properly without information and evidence. Brunet, *supra*, at 34.

The unavailability of discovery in arbitration generally favors corporate interests, to the individual's detriment. Absent discovery, individuals frequently will be unable to succeed on their claims, because the corporation customarily will have exclusive possession of the information and documents necessary to prove the claims. Budnitz, *supra*, at 283-84. Arbitrators frequently confine their review to documents relating solely to the affected individual, and do not examine underlying policies or evidence of business practices which would be necessary to award broader relief. For example, it would have been impossible for plaintiffs to prevail on their challenge to excessive late and overlimit fees in *Beasley v. Wells Fargo Bank, supra*, without discovery into the bases on which the bank decided to impose those charges and

the cost data which it claimed supported the propriety of the charges. In short, the unavailability of discovery skews the system in favor of corporate defendants. David S. Schwartz, *Enforcing Small Print To Protect Big Business: Employee And Consumer Rights Claims In An Age Of Compelled Arbitration*, 1997 Wis. L. Rev. 33, 61 (*"Small Print"*).

C. Arbitration Has Been Adopted To Preclude Representative Consumer Actions.

Consumers who must resolve their disputes through arbitration often lose the right to bring representative actions; as a result, in cases involving small claims they are denied any effective remedy against unlawful business conduct. Statutes such as the Truth in Lending Act, 15 U.S.C. §§ 1601 *et seq.*, rely on private enforcement through representative actions, and the congressional design for private enforcement would be frustrated by compelled arbitration. But mandatory arbitration clauses are now being relied on by industry to argue that consumers must individually arbitrate each claim and are deprived of any right they might have to pursue consolidated claims, group or collective actions, or class actions unless the arbitration clause includes an agreement allowing such procedures. This argument, of course, ignores the reality that an arbitration clause unilaterally drafted by the financial institution to limit its liability will never include a provision permitting such actions.

It also disregards the Court's precedents. In *Deposit Guaranty National Bank v. Roper*, 445 U.S. 326, 338 n.9 (1980), the Court stated:

> A significant benefit to claimants who choose to litigate their individual claims in a class-action context is the prospect of reducing their costs of

> litigation, particularly attorney's fees, by allocating such costs among all members of the class who benefit from any recovery. Typically, the attorney's fees of a named plaintiff proceeding without reliance on Rule 23 could exceed the value of the individual judgment in favor of any one plaintiff. Here the damages claimed by the two named plaintiffs totaled $1,006.00. Such plaintiffs would be unlikely to obtain legal redress at an acceptable cost, unless counsel were motivated by the fee-spreading incentive and proceeded on a contingent-fee basis. This, of course, is a central concept of Rule 23.

The Court reiterated in *Amchem Products, Inc. v. Windsor*, 117 S. Ct. 2231, 2246 (1997), that absent class actions, individuals whose damages are small will have no realistic prospect of obtaining relief:

> The policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights. A class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone's (usually an attorney's) labor.

The observation that there is no incentive for individuals with only small potential recoveries to pursue their claims applies forcefully to this case and others like it. *See Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 809 (1985) ("Class actions . . . may permit the plaintiffs to pool claims which would be uneconomical to litigate individually. . . . [M]ost of the plaintiffs would have no realistic day in court if a class action were not available."); *Weinberg v. Hertz Corp.*, 499 N.Y.S.2d 693, 696 (N.Y. App. Div. 1986), *aff'd*, 516 N.Y.S.2d 652 (N.Y. 1987) ("[I]t is notable that in determining whether a class action is superior to

other viable methods, it is clear that most of the individuals having claims averaging less than $31 would have no realistic day in court if a class action were not available."); 4 Herbert Newberg, *Newberg on Class Actions* § 21.01 at 21-3 (3d ed. 1992) ("There are compelling reasons for bringing consumer protection class actions. A class-based effort is more effective than an individual consumer in getting a defendant to modify its conduct. Most individual consumers have claims which are too small to warrant representation by an attorney.")

Therefore, arbitration is not simply an alternative forum, but no forum at all for the overwhelming majority of consumers with small monetary claims. Unless they are able to aggregate those claims and litigate them in a class action, consumers will have no effective means of redress. In the consumer context, where small amounts are often at stake, in the absence of class litigation, unlawful and deceptive conduct which deprives large numbers of people of small amounts of money in violation of statutory proscriptions will be allowed to continue with no meaningful deterrent.[6]

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[6] This is not piecemeal litigation, which the Court indicates may be necessary to give effect to an arbitration agreement in *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 20 (1983). There, the consequence was simply that the hospital's dispute with the construction company might be decided in arbitration, while the hospital's claim for indemnity for any liability it had to the construction company against the architect, with whom it had no arbitration agreement, would be resolved in court: "an arbitration agreement must be enforced notwithstanding the presence of other persons who are parties to the underlying dispute but not to the arbitration agreement." *Id.* Here, the consequence will be that consumers are deprived of any remedy whatever because their individual claims are too

Lenders like Green Tree have adopted arbitration clauses as a way of giving themselves an economic and tactical advantage by significantly reducing the likelihood of representative litigation. Alan S. Kaplinsky is quite clear in recommending to his institutional clients that they adopt arbitration clauses as a way of defending themselves against class action lawsuits. "Arbitration is a powerful deterrent to class action lawsuits against lenders. . . . " Kaplinsky & Levin, *Predator, supra,* at 24. Elsewhere, the same authors have asserted that courts cannot compel class arbitration if parties have not agreed to it. Kaplinsky & Levin, *Alternative, supra,* at 848.

These authors contend that: "[A]ll of the dangers inherent in an individual consumer lawsuit – the threats of costly and drawn-out litigation, runaway juries, gargantuan punitive damages awards and adverse publicity – are magnified exponentially when a class of . . . consumers is certified." They further assert: "Stripped of the threat of a class action, plaintiffs' lawyers have much less incentive to sue." Kaplinsky & Levin, *Predator, supra,* at 26.

They predict a future free from the threat of consumer challenges to the industry:

> It is anticipated that virtually all major banks and lending institutions will implement consumer arbitration procedures within the next five years. Lenders that have not yet implemented arbitration programs should promptly consider doing so, since each day that passes brings with it the risk of additional multi-million-dollar class action lawsuits that might

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small for them to have any realistic probability of obtaining relief.

> have been avoided had arbitration procedures been in place.

Id. at 28.

The intent to change the rules to favor business interest at the expense of consumers by eliminating the primary remedies against abusive practices that deprive small sums of money from a large number of individuals could hardly be clearer. In another communication from NAF, Curtis D. Brown, its Vice President and General Counsel, states to a prospective industry client that "A number of courts around the country have held that a properly-drafted arbitration clause in credit applications and agreements *eliminates class actions* and ensures that credit-related lawsuits will be directed to arbitration, not a jury trial." (App. 50) (emphasis in original).

The preclusion of representative actions would result in consumers with relatively small claims being denied any effective remedy against unlawful business conduct. Frequently, many consumers are harmed by the same wrongful practice, yet individual actions are usually impracticable because the individual recovery would be insufficient to justify the expense of bringing a separate lawsuit. Without representative actions, wrongdoing businesses would be able to profit from their misconduct, violate statutory rules with impunity, and retain their ill-gotten gains. Representative actions by consumers aggregate their interests, enable them to take on economically powerful institutions, make wrongful conduct less profitable by obtaining disgorgement of ill-gotten gains, and have a salutary deterrent effect. *See* National Association of Consumer Advocates, *Standards and Guidelines for Litigating and Settling Consumer Class Actions*, 176 F.R.D. 370, 377-78 (1998).

Consumer cases differ significantly from matters involving securities and age discrimination, where administrative agency involvement can be relied on to ensure the sufficiency of the arbitration procedures to adequate enforcement of statutory protections. In *Shearson/American Express v. McMahon*, 483 U.S. 1056 (1987), the Court noted the importance of the oversight authority of the Securities and Exchange Commission and found arbitration procedures which had been approved by the Commission adequate to protect statutory rights. Here, in stark contrast, the arbitration provider and procedures are unknown, so their adequacy to protect statutory rights is wholly speculative.

Similarly, in *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991), the Court found reason to believe that statutory rights would be safeguarded even if individuals could not bring class actions because the EEOC could bring actions on behalf of classes of persons. Here, by contrast, there is no requirement for first filing charges with an agency comparable to the EEOC which could then bring actions for damages and equitable relief on behalf of a class. Hence, there is no meaningful check against abusive and predatory arbitration processes imposed on consumers.

The Court has recognized the important distinction between consumer and commercial contracts in *Rodriguez De Quijas v. Shearson/American Express*, 490 U.S. 477, 484 (1989), overruling *Wilko v. Swan*, 346 U.S. 427 (1953), which held that claims arising under the Securities Act of 1933 were not subject to arbitration, saying: "We now conclude that *Wilko* was incorrectly decided and is inconsistent with the prevailing uniform construction of other federal statutes governing arbitration agreements *in the*

setting of business transactions." (Emphasis added). The Court thus specifically limited its holding to arbitration in the commercial context.

Thus, for the consumer dispute involved here, there will be no effective brake against illegitimate and abusive arbitration clauses absent intervention by the Court.

D. There Is Virtually No Right To Appeal An Incorrect Arbitrator's Award.

The FAA establishes only very limited bases for appealing an arbitral award in 9 U.S.C. § 10, and for a court to vacate, modify, or correct an award in 9 U.S.C. § 11. An arbitrator's award may only be reversed on a showing that it was obtained by corruption, fraud, or prejudicial misconduct. Combining that standard with the fact that arbitrators generally need not rule according to the law, and need not give reasons for the decision, the effect is that any right to appeal is essentially eliminated, and decisions will not be reversed even if they are wrongly decided.

As this Court has noted, a court will set an arbitrator's decision aside only in very unusual circumstances. *First Options, Inc. v. Kaplan*, 514 U.S. 938, 942 (1995). In fact, courts virtually never reverse arbitral decisions. Sternlight, *Panacea, supra*, 18 n.9; Schwartz, *Small Print, supra*, at 3. This raises serious questions about the fairness of arbitration, because parties lose the important ability to remedy mistakes of fact or law, which does not exist when an erroneous trial court decision is appealed. Even in the limited circumstances in which a court can overturn an arbitrator's decision, because arbitrators need not explain the bases for their decisions or make a

complete record of the proceedings, aggrieved individuals are often ill-equipped to satisfy their burden of proof on appeal. *See, e.g., Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, 808 F.2d 930, 933 (2d Cir. 1986).[7]

Petitioners' contention that post-arbitration review would be sufficient to remedy any refusal to award a prevailing plaintiff costs and attorney's fees (Brief of Petitioners at 41) is belied by the case law. For example, the Second Circuit refused to find that an arbitrator's failure to award attorneys fees in an age discrimination case met the manifest disregard of the law standard. In *DiRussa v. Dean Witter Reynolds*, 121 F.3d 818 (2d Cir. 1997), the court held that although a prevailing plaintiff's entitlement to attorney's fees under the ADEA was well-defined, explicit, and clearly applicable, the manifest disregard standard was not met because there was no persuasive evidence that the arbitrator had understood that an award of attorney's fees was mandatory and yet had intentionally refused to comply with the law. It would be virtually impossible to satisfy such a stringent test, so there is no assurance whatever that post-arbitration review would result in awards of attorney's fees to prevailing plaintiffs, as the statute mandates.

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[7] A decision by California's highest court indicates the degree of deference accorded an arbitral decision. In *Moncharsh v. Heily & Blase*, 832 P.2d 899, 900 (Cal. 1992) (en banc), an arbitrator's decision was found not generally reviewable, even if it was incorrectly decided as a matter of fact, or erroneously decided on the law.

E. Arbitration Undermines Public Accountability.

Another reason financial institutions attempt to compel arbitration is to escape the publicity which accompanies litigation. Budnitz, *supra*, at 271, 285. The defense bar has admitted that arbitration reduces the risk of adverse publicity. Kaplinsky & Levin, *Alternative, supra*, at 847. Arbitration is essentially conducted in private. Brunet, *supra*, at 13. Both the proceedings and the decisions are required to remain confidential. *Id.*

Businesses favor this privacy, preferring customer disputes to remain free from the disinfecting rays of public scrutiny. Businesses naturally fear that publicity may reduce customers' trust, alert regulators to unfair practices or spotlight illegal conduct. Budnitz, *supra*, at 285.

The publicity accompanying litigation, in contrast, enhances accountability and furthers the public interest in ensuring the laws are enforced. The publicity following a verdict of fraud or deceptive practices lets consumers and regulators know about illegal practices. *Budnitz, supra*, at 313. The inability of consumers to learn about the experiences of other people closes off access to an important source of this useful information, and allows companies to control information. "The lack of publicity may be particularly detrimental in the context of consumer claims because one set of consumers will not be able to learn from the misfortunes of others." Sternlight, *Panacea, supra*, at 695 & n.326. Confidentiality undermines the governmental enforcement and regulatory apparatus designed to protect the consumer and ensure a fair marketplace. Budnitz, *supra*, at 327.

Requiring that disputes be resolved by arbitration, from which governmental entities are excluded, also creates a disincentive for consumers to complain to agencies. That deprives agencies of the data they need to identify patterns and practices of unlawful behavior and limits their ability to take appropriate enforcement and regulatory action. Budnitz, *supra*, at 312-313. The lack of publicity also reduces the likelihood that other companies will modify their practices, as often occurs after a publicized court decision or jury award.

F. Arbitration Impedes Development of the Common Law.

Resolving disputes privately also impedes the continued development of a body of consumer protection law. Budnitz, *supra*, at 312. Industry counsel readily acknowledge that because arbitrations are confidential and arbitrators are not required to issue a written opinion, development of the common law is stifled. Kaplinsky & Levin, *Alternative*, *supra*, at 848. Stunting the development of this common law clearly harms consumers. *See* Brunet, *supra*, at 19-20.

The Rand Study expresses grave concern about arbitration's lack of public standards:

> Since the results of private arbitration are not usually matters of public record, they cannot be used in these fashions, to establish standards of conduct for the future or to bring attention to unwanted behavior. This brings into serious question the legal system's ability to effect changes in the common law and in statutory interpretation when private ADR is widespread.

Moller et al., *supra*, at xiii.

The Rand Study also notes the adverse public consequences of private dispute resolution. It describes the danger that arbitration will silence cases involving potentially damaging precedents or information, and that cases that would once have been part of the common law through litigation will be lost to the system, thus failing to provide a guide for future behavior. *Id.* at 10 and 32. In a later study, scholars from the Rand Institute for Civil Justice further explain that the most significant threat to the evolution of case law is posed by the prospect that whole classes of disputes might be removed from the public sector. Rolph, et al., *Escaping the Courthouse, supra,* at 62. That threat, unfortunately, is being realized in the consumer financial services arena.

G. Arbitration Allows the Financial Services Industry to Deregulate Itself.

The use of arbitration clauses gives large firms power to displace the judiciary from its role in enforcing statutory rights. Schwartz, *supra,* at 37. By selecting mandatory binding arbitration, institutions avoid applicable precedent or resort to regulatory agencies, and limit their liability, so that the arbitration clauses function as a kind of corporate self-deregulation. Forcing disputes involving statutory claims into arbitration delegates to arbitrators the role of industry regulator. Budnitz, *supra,* at 320. "The real problem comes when parties who are otherwise protected by an important public law are compelled to use an ADR procedure in lieu of coming to court and then have no meaningful review in court." Harry T. Edwards, *Where Are We Heading With Mandatory Arbitration Of Statutory Claims In Employment?* 16 Ga. St. U. L. Rev. 293, 295

(1999). Judge Edwards emphasizes that a public enforcement mechanism is required to protect statutory rights. *Id.* at 297.

H. The Benefits of Arbitration Are Illusory.

Not only is there no proof that arbitration is cheaper, but there also is no support for the claim that it is better for individuals. Arbitration awards for consumers generally are smaller. Schwartz, *supra*, at 9. This is confirmed by the Rand Study, which found that awards in arbitration decisions were typically less than those in jury verdicts. Moller et al., *supra*, at 11.

The claim of *Amici* American Bankers, et al. that consumers will be successful in arbitration because one commentator found that employees do well (Brief at 19-20), is thus contravened by the limited existing data, and unpersuasive, in light of their own admission that "there are no major studies analyzing arbitration in the consumer context." *Id.* at 17.

I. Arbitration Also Reflects An Anti-Consumer Bias.

Arbitrators are often biased in favor of large corporate "repeat player" clients. Arbitrators face powerful economic incentives that can affect their neutrality. If an arbitrator rules against a corporate client too often, the company can easily take its business to another arbitrator. Sternlight, *Panacea, supra*, at 684-85; Schwartz, *supra*, at 60-61. "Considering the parties' frequency of need for an arbitrator, the arbitrator's necessary qualifications for being selected, and the payment plan, the odds are against the individual plaintiff versus the manufacturers, health providers, and corporate landlords who will likely

be parties to dispute resolution time and again." James L. Guill, Edward A. Slavin, Jr., *Rush to Unfairness: The Downside of ADR*, 28 Judges' Journal 1, 8, 11 (1989). A study of this phenomenon in the employment context concludes that employees recover a lower proportion of their claims in repeat player cases than in non-repeat player cases. L. Bingham, *Employment Arbitration: The Repeat Player Effect*, 1 Emply. Rts. & Empl. Policy Journal 1 (1997).

Another example of arbitrations conducted by NAF for First USA is illustrative. In almost 20,000 cases, the vast majority of them brought by the company, NAF arbitrators ruled for First USA 99.6% of the time. Caroline E. Mayer, *Win Some, Lose Rarely? Arbitration Forum's Rulings Called One Sided*, The Washington Post, March 1, 2000 (App. 52). Such an overwhelming disparity in results raises serious questions about the fairness of the process.

In short, Green Tree's arbitration clause is illegitimate because petitioner has adopted it not to obtain an alternative forum, but to obtain an unfair advantage over its consumers.

II. IN OPERATION, GREEN TREE'S CLAUSE PERMITS PETITIONER TO OBTAIN POSSESSION OF THE PROPERTY SUBJECT TO THE DISPUTE BEFORE ARBITRATION IS CONCLUDED.

Not only does petitioner's clause materially shift the economic costs and risks of dispute resolution onto respondent, but it also allows petitioner to take possession of the property subject to the dispute outside of the arbitration process. In particular, Green Tree's clause provides:

> Notwithstanding anything hereunto the contrary, we retain the option to use judicial or nonjudicial relief to enforce a mortgage, deed of

> trust, or other security agreement relating to the real property secured in a transaction underlying this arbitration agreement, or to enforce the monetary obligation secured by the real property, or to foreclose on the real property. Such judicial relief would take the form of a lawsuit. The institution and maintenance of an action for judicial relief in a court to foreclose any collateral, to obtain a money judgment or to enforce the mortgage or deed of trust, shall not constitute a waiver of the right of any party to compel arbitration regarding any other dispute or remedy subject to arbitration in this contract, including the filing of a counterclaim in a suit brought by us pursuant to this provision.

(J.A. 36). By its plain terms, this clause allows Green Tree to split all disputes with its customers and to obtain judicial or non-judicial foreclosure and even a money judgment prior to or even in spite of a contrary ruling by an arbitrator. Green Tree therefore retains the significant threat of repossession and claim preclusion outside of the arbitration process. Since Green Tree itself controls how the arbitration process is commenced, including the costs involved, it can time that process to maximize its litigation leverage (including claim and issue preclusion) by proceeding with repossession while relegating even consumer counterclaims to arbitration. Thus, while petitioner and its amici trumpet the supposed merits and efficiency of arbitration, they have, in fact, stacked the litigation deck in their favor by reserving for themselves alone the right to proceed in a judicial forum.

The illegitimacy of such a provision is apparent in the fact that a consumer is left powerless under the contractual language. Any plea to an arbitrator to enjoin Green Tree from proceeding with a foreclosure or money judgment claim would certainly be met with the argument that

the arbitrator lacked such power. Indeed, the same clause expressly reserves the judicial option to Green Tree, thus precluding arbitral review or intervention.

This unique contrivance certainly distinguishes the present clause from all the other arbitration clauses the Court has previously considered under the FAA. In contrast with those cases, the clause here is clearly intended to tilt the dispute resolution landscape in petitioner's favor. It is not intended to provide an alternative forum. It is intended to lock consumers away in a private, unspecified process, the initiation and costs of which are totally controlled by Green Tree. Neither Congress nor the Court ever intended the FAA to permit such a result.

III. GREEN TREE'S ARBITRATION CLAUSE IS ILLEGITIMATE BECAUSE IT FAILS TO SPECIFY HOW ARBITRATION IS INITIATED AND IS NOT CONSENSUAL.

Petitioner's clause lacks an essential element necessary for legitimacy under the FAA – notice of how the dispute resolution mechanism is initiated. Under the clause, Green Tree selects the arbitrator. But there is absolutely no notice of how that selection process is initiated. Does the consumer simply write to Green Tree? Does the consumer call? Does the consumer refuse to pay his or her bill?

In *Fuentes v. Shevin*, 407 U.S. 67 (1972), the Court emphasized that "a waiver of constitutional rights in any context must, at the very least, be clear." *Id.* at 95. In this regard, notice and an opportunity to be heard have been the hallmarks of the Court's due process analysis. The *Fuentes* Court emphasized that form contractual provisions in consumer transactions purporting to waive these

basic due process rights would not be enforced if evidenced only by a consumer's signature on the contract. *See id.; see also Swarb v. Lennox*, 405 U.S. 191 (1972); *cf. D.H. Overmyer Co. v. Frick Co.*, 405 U.S. 174 (1972).

In this case, the impact of petitioner's tilted arbitration clause is no less drastic to consumers than were the confiscatory confession of judgment clauses struck down in *Fuentes* and *Swarb*. As in those cases, Green Tree's customers here confront the very real likelihood of losing their property without any effective notice or opportunity to be heard to prevent that eventuality. Although there is the sham appearance of such an opportunity, the alternative arbitration forum and process is so controlled by Green Tree and the remedies are so restricted that the arbitration is really a modern-day confession of judgment.

Applying fictional concepts of consent to adhesionary contracts between financial institutions and consumers distorts the law of contract and the traditional use of the arbitration mechanism beyond recognition. Arbitration is a creature of contract, premised on the ability of parties of equal bargaining power to choose what method of resolving disputes will best serve their mutual needs. This Court has frequently acknowledged that arbitration is premised on consent. *Volt Information Sciences, Inc. v. Board of Trustees*, 489 U.S. 468, 479 (1989) (arbitration is a matter of consent, not coercion).

Meaningful consent simply does not exist in the present case. Unlike the parties to most contracts between business entities, individuals contracting for goods and services generally do not have equal bargaining power. In most instances, a marked imbalance in knowledge and power characterizes such contracts. Adhesionary contracts are not freely negotiated, but are offered on a take-it-or-leave-it basis. They are imposed by a powerful party

on a relatively powerless party who has no ability to negotiate. Budnitz, *supra*, at 328. Indeed, the essence of form contracts is that they can rarely if ever be negotiated by the consumer. Sternlight, *Panacea, supra*, at 676-77.

The Restatement (Second) of Contracts notes that "[a] party who makes regular use of a standardized form of agreement does not ordinarily expect his customers to understand or even to read the standard terms." Restatement (Second) of Contracts § 211 comment b (1979). When the party with superior sophistication, knowledge, and financial resources inserts a mandatory arbitration clause into a form contract, individuals usually are unaware of and cannot reasonably be said to have consented to these terms. *See Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 599 (1991) ("the common law . . . subjects terms in contracts of adhesion to scrutiny for reasonableness"). Rather, the reality is, as Professor Sternlight points out,[8] consumers do not understand either the terms or their import.

Unilateral imposition of mandatory, binding arbitration in adhesionary contracts has none of the indicia of choice, consent, or bargaining. Instead, it is well recognized that: "[w]ith the growth of ADR has come a strong element of compulsion and coercion." Katz, *Two-Headed Monster, supra*, at 1.[9] The compulsion and coercion here

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[8] Sternlight, *Panacea, supra*, at 688-693, and studies cited at n.290, 289, and 300.

[9] The compulsion and coercion which are inherent in the mandatory imposition of alternative dispute resolution mechanisms has led the European Commission to file comments opposing alternatives which preclude consumers' recourse to the courts in e-commerce disputes. (App. 59).

has deprived respondent of basic due process and renders petitioner's clause illegitimate under the FAA.

CONCLUSION

The FAA does not legitimate one-sided agreements which attempt to give the institutional party an unfair advantage over its consumer customers. So long as mandatory, pre-dispute clauses are used to change the rules by which disputes are resolved, and limit industry liability, their use will not accomplish the ostensible goals of inexpensive, prompt and fair dispute resolution. Where, as here, business interests seek to gain an unfair advantage, preclude class and representative actions, constrict the availability of statutory remedies, limit or eliminate any challenge to their deceptive business practices, and increase costs to consumers, their abusive arbitration clauses should be deemed unenforceable.

Respectfully submitted,

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POSITION PAPER: REASONS TO OPPOSE PRE-DISPUTE ARBITRATION CLAUSES IN CONSUMER CONTRACTS

I. Overview.

Recent years have witnessed an assault on the rights of consumers to access to the courts, and to trial by judge and jury. Banks, credit card companies and other financial institutions are jeopardizing consumers' rights to the protections afforded them by statutory and case law through the use of mandatory, binding arbitration clauses. These clauses are drafted by the financial institutions and unilaterally inserted in adhesionary contracts with consumers, without negotiation or consent. Arbitration as a method of resolving disputes is a creature of contract premised on the ability of parties of equal bargaining power to choose what method of resolving disputes will best serve their mutual needs. Free choice is the foundation of all alternative dispute mechanisms, including arbitration, and the reason such clauses are enforceable is because they reflect the bargain between the parties. Unilateral imposition of binding arbitration raises troublesome issues for consumer advocates because of the

potential for abuse by institutional interests and the consequent denial to consumers of access to the courts and to justice.

II. Specific Problem With Pre-Dispute Arbitration Clauses.

A. The purpose and intent of such clauses is to insulate unlawful, unfair, or deceptive practices from any meaningful review by making it difficult to obtain discovery, impairing consumers' ability to proceed on behalf of a class, and to reduce compensatory and punitive damage awards.

B. By placing arbitration clauses into contracts before a dispute arises, the consumer is deprived of any way to intelligently decide if she really wants arbitration or if it will be an appropriate way to resolve that particular dispute.

C. Discovery is not available as a matter of right, but is within the discretion of the arbitrator. This can make the proceedings very unfair to consumers if they need to obtain documents from the defendant to demonstrate the nature and scope of challenged business practices.

D. Arbitration, unlike the court system, requires that the parties pay a high filing fee as well as a daily fee to the arbitrator(s), and may impose other fees for hearings, processing, and administration. The costs of arbitrating may exceed the costs of litigating, and are often in excess of the amount in dispute.

E. The arbitrator need not follow precedent or explain the reasons for his or her decision, so consumer protection statutes and case law can be ignored.

F. The proceedings are secret, so challenged practices will not be brought to the attention of the public generally or to the regulatory authorities such as the Federal Trade Commission, making it more difficult for abusive practices to be uncovered.

G. An arbitrator does not have the power to order injunctive relief. The consumer victimized by a widespread business practice may obtain individual recovery, but may not be granted an order that the wrongful practice cease.

H. The arbitrator's decision is immune from judicial review, except on very narrow grounds, such as fraud by the arbitrator, and a decision is final and binding even if it is wrongly decided as a matter of fact or incorrect as a matter of law.

I. The company chooses the forum, which can lead to proceedings which are conducted in an inconvenient forum and are inordinately expensive.

J. The supposed preference for arbitration as a means of resolving disputes is derived from a series of Supreme Court cases between commercial entities which had bargained for the speed and efficiency of arbitration, so the Court was merely enforcing a freely negotiated contractual agreement between parties of equal bargaining power. That rationale is inapplicable to cases involving consumers who did not know about, negotiate, or accept the clause.

K. Defendants argue that arbitration may not proceed on a class wide basis, requiring consumers to pursue each case individually and depriving them of a very important procedural tool for stopping wrongful conduct and obtaining meaningful relief.

L. Future consumers are deprived of the clarification and development of consumer law through the courts. Statutes and regulations are full of ambiguity

and uncertainty which case, law could rectify and which the drafters of new and revised laws need for informed decisionmaking.

App. 5

DISPUTE RESOLUTION MAGAZINE

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FACE OFF: Should Binding Arbitration Clauses be Prohibited in Consumer Contracts?

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FACE-OFF

Should Binding Arbitration Clauses be Prohibited in Consumer Contracts?

by Patricia Sturdevant and Dwight Golann

YES:
Pre-Dispute Arbitration Clauses are Unfair to Consumers

Patricia Sturdevant –

NO:
Binding Arbitration is the Only Practical Solution to Many Consumer Disputes

– Dwight Golann

YES Mandatory binding arbitration imposed by a business entity on a consumer should have no place in our justice system. Arbitration as a method of resolving disputes is a creature of contract premised on the ability of parties of equal power to choose what method of resolving disputes will best serve their mutual needs. Free choice is the foundation of all alternative dispute mechanisms, including arbitration. Unilateral imposition of

those alternatives raises troublesome issues for consumer advocates because of the potential for abuse by institutional interests and the consequent denial to consumers of access to the courts and to justice.

The essence of arbitration is that it is consensual. The Federal Arbitration Act does not express any preference for arbitration, but simply for enforcing privately negotiated agreements to arbitrate, like other contracts, according to their terms. The purpose of the Act was to enable merchants who had negotiated arbitration agreements to enforce those agreements. It was never intended to force parties to arbitrate disputes they had not agreed to submit to that forum.

Because the consequences of arbitration are severe, consent should never be uninformed or implied. Even arbitral decisions that are wrong as a matter of fact or law and result in a manifest injustice cannot be overturned on appeal. (See, for example, *Moncharch v. Heily & Blase*, 832 P.2d 899 (Cal. 1992).) The rationale for tolerating the possibility of an unfair or incorrect resolution of a dispute is that parties who have made the bargain to arbitrate, knowing a decision is final and binding, should be held to it. But this rationale is wholly inapplicable when, as in most consumer contracts, there is no actual agreement to arbitrate. No system of resolving disputes can be considered fair if it exposes the parties to manifest injustice without their consent. Nor does a system of speedy, economical injustice solve the problem of court overcrowding in a socially acceptable way.

Arbitration works best in resolving disputes of a factual nature between parties who desire to continue an existing

business relationship and who have willingly agreed to submit their disputes to arbitration. Proponents of pre-dispute arbitration clauses in consumer contracts often obscure the crucial distinction between voluntary arbitration, which can be extremely useful, and mandatory arbitration, which is a contradiction in terms, like minor surgery. Proponents of these clauses also ignore the fact that the purposes of such arbitration clauses are to avoid jury trials and to minimize the institution's exposure for high compensatory and punitive damage awards. Yet, because it is constitutionally guaranteed, the right to trial by jury can only be waived voluntarily with an awareness of the existence of the right and the consequences of giving it up. Pre-dispute arbitration clauses in contracts that are not negotiated seldom meet those standards.

Twice recently the California Court of Appeals has refused to enforce arbitration clauses in adhesion contracts on the grounds that such clauses are outside the reasonable expectations of consumers. In *Patterson v. ITT Consumer Financial Corp.*, 18 Cal. Rptr. 2d 563 (Ct. App. 1993), the court found that an arbitration clause that was not pointed out to the borrowers by the lender constituted an unfair surprise, and that arbitration in a distant forum was beyond the borrowers' reasonable expectations. The court concluded that the clause was unconscionable because the proceedings were costly, the rules for obtaining a local forum were incomprehensible, and the process seemed designed to discourage borrowers from obtaining a hearing. And in *Bell v. Congress Mortgage Co.*, 30 Cal. Rptr. 2d 205 (Ct. App. 1994), the court considered the entire context of the transaction: the disparity in bargaining strength between the parties, the borrowers'

relative lack of sophistication, the absence of negotiation, the obscuring of the arbitration provision in voluminous text and in the midst of a recitation of rights secured to the borrowers, and the lender's failure to point out the clause. The court held that under this combination of circumstances "an adhesion contract must elicit a clear and informed waiver" of the right to trial by jury, and that the contract in question had not done so.

These judicially imposed limits on enforceability recognize the reality that non-negotiated, non-consensual pre-dispute clauses between parties of unequal power are potentially abusive. Federal law on unconscionability also limits the enforceability of pre-dispute clauses that are outside the reasonable expectations of the weaker party, or are procedurally and substantively unconscionable.

Businesses can reduce their litigation expenses and better serve their shareholders' and customers' interests in a variety of fair and legitimate ways. They can describe the various alternative dispute mechanisms available and allow consumers to elect one or none at the time a dispute arises. Or they can require arbitration by contract, but allow a consumer dissatisfied with the result the option of litigation. Either of these alternatives would reduce costs and speed dispute resolution while providing safeguards against abuse and unfairness.

Alternative dispute resolution mechanisms can serve a useful and important purpose when the parties agree to them. But to create both the appearance and reality of fairness and justice, arbitration, like sex, must be based on consent, not on coercion.

Patricia Sturdevant is a partner with the firm of Sturdevant & Sturdevant, in San Francisco, California.

NO If all consumers had access to a skilled, tenacious advocate like Pat Sturdevant and a jury available to hear their case, it would be harder to argue for pre-dispute arbitration clauses. In the real world, however, consumers usually don't have either. So well written ADR clauses make sense, both for businesses and their customers.

Corporations often write arbitration clauses into consumer contracts to avoid high litigation costs, inexpert judges, and, let's be candid, juries. Although some companies are concerned about the attitudes of jurors, what many businesses say they fear most is their unpredictability. A few companies also seem to be attempting to create an improper "home-field advantage" by specifying inaccessible venues, little-known ADR administrators, and the like.

The fact that the pre-dispute arbitration clauses may be good for businesses, however, does not necessarily mean that they are bad for consumers. Let me tell you about my heat pump. What's a heat pump? It's an engineering marvel that both heats and cools a room by pulling heat out of the air. Like many other innovations, heat pumps seem to work better in California than in the frigid air of New England. Ours died, was resuscitated at great expense, and died again. The unit was still under an implied warranty, but the manufacturer refused to fix it.

I have a breach of warranty claim worth about $3,000, as well as statutory legal rights. *But how can I enforce them?* I can't go to small claims court with this claim: it's

twice the jurisdictional limit. I could sue in district court and have a jury trial for breach of warranty (although not for violation of Massachusetts' "little FTC" act). But to get a trial I need a lawyer, and no one will take a $3,000 case on contingency. Even if they did, our local court has a year's backlog, which only begins to run after discovery is completed. Thus, a decision is at least two years away, assuming no appeals are taken.

Things look almost as bad for the pump manufacturer. Its lawyer's fee will probably exceed my claim, so it might agree to settle. But it hasn't yet, and as the plaintiff I have to move first. In these circumstances most consumers, neither knowing their rights nor being able to enforce them, simply "lump it." Compared to these bleak options, a quick, cheap, and final system of contractual arbitration looks very attractive.

There are, of course, much bigger consumer claims, such as cases involving new-car lemons and mortgage violations. But even these grievances usually don't involve large sums of money per claimant. And as the size of the claim increases, so do the complexities and individual variations. I recently asked a nationally known advocate for the poor why more mortgage class actions aren't being brought. "We get calls from class-action lawyers," she said, "but they usually want 'cookie cutter' cases." In other words, they want the kind in which essentially identical claims can be litigated or settled en masse. I would too if I were a plaintiffs' lawyer, but this approach automatically rules out most cases that involve individualized facts – like misleading mortgage pitches and my broker heat pump.

Reforming the Litigation System. One solution would be court reform: raising small claims limits, adding judges, and the like. Most of us are not patient or hopeful enough to wait for this. Another might be the system Pat Sturdevant advocates, where litigants negotiate over arbitration after the claim arises and the issues are known. If arbitration offered a fair solution to both sides, litigants would presumably choose it voluntarily.

But this assumes that the consumer has pursued his or her case and found a lawyer who understands arbitration, an unlikely event in my experience. Also, once a claim is filed, the defendant usually hires an outside litigator, and national companies often engage local counsel. As more than one corporate general counsel has complained, litigators often come up with endless reasons why a case has to remain in the court system. Although they may suspect that they are being milked for fees, corporate counsel often feel that they must defer to the litigator's knowledge of the local legal culture. For all these reasons, once a case enters the judicial system, it rarely gets out, even when arbitration would make sense for everyone.

Making Arbitration Work for Consumers. This said, there are serious problems with some of the form arbitration clauses being used today. The question is how to make arbitration work for both sides in consumer transactions. I don't think consumers can realistically be expected to bargain for themselves or will have lawyers to represent them. Thus, legislation will be needed. And since the Federal Arbitration Act has been held to preempt most state laws governing arbitration, the solution must come from the federal government. Examples of the kind of

legislation I have in mind are the Magnuson-Moss Warranty Act, which imposed minimum federal standards on consumer warranties, and the Federal Trade Commission's Credit Practices Rule, which outlawed several unfair collection remedies in consumer contracts.

What should such legislation or regulations cover? It's hard to specify a "one size fits all" system, but among the key provisions should be the following:

Guarantees of neutrality. Arbitration administrators and neutrals should meet minimum requirements for independence from litigants; they should not depend for more than a minor portion of their revenue on any single customer.

Compliance with law. Consumer arbitrators should be obligated to apply the extensive body of consumer legislation that has been adopted over the past generation, not simply their personal ideas of fairness.

Venue. Arbitration should take place where the transaction occurred.

Fees. Administrative fees for consumers should be comparable to those imposed by courts; businesses that want to arbitrate should bear the extra cost of doing so.

Graduated discovery. Consumers need streamlined discovery, in proportion to the amount at stake in the case.

Reasoned opinions and appeals. Parties need not have broad rights of appeal except perhaps in the largest cases, but arbitrators should provide a summary of their reasoning, as an internal check on their performance.

Ability to grant relief. Arbitrators are sometimes referred claims, such as class actions, that they are incapable of administering, and sometimes receive requests for relief, such as for punitive damages, that they may have no legal power to grant. A claim should not go to arbitration unless the arbitrator can administer it and has the authority to grant the relief available from a court.

Conclusion. With these reforms, some businesses may no longer be interested in using arbitration clauses. But with such protections, a pre-dispute commitment to arbitrate can be a good deal for everyone.

Dwight Golann is Professor of Law at Suffolk University Law School, in Boston Massachusetts. He is an active mediator and serves as Chair of the Consumer Financial Services Committee of the ABA's Section of Business Law.

[LOGO]
Bank America Corporation

NEWS

Peter Magnani
(415) 953-2418

For release:
IMMEDIATE

BANK OF AMERICA ADOPTS ALTERNATIVE DISPUTE RESOLUTION

SAN FRANCISCO, June 2, 1992 – Bank of America has modified all of its deposit and Bankcard account contracts to provide for alternative methods of resolving legal claims arising from complaints by customers. The move is expected to provide customers a means of resolving disputes with the bank that is faster, less costly, and more reliable than litigation, while enabling the bank to manage the costs of resolving customer complaints more effectively.

Beginning immediately, if a customer files a lawsuit against the bank, either party can elect to have the matter resolved through binding arbitration under the rules of the American Arbitration Association. The Association then appoints an arbitrator – usually a practicing attorney – from a list that is acceptable to both parties. The arbitrator conducts an informal hearing and renders a decision, which is binding on both parties.

"The great majority of customer complaints are resolved quickly and routinely, often with a simple telephone call," said Winslow Christian, Senior Vice President and Director of Litigation at Bank of America. "But occasionally, we are unable to resolve a dispute satisfactorily and the customer feels that the only available recourse is to file a lawsuit. This is an expensive and time

consuming effort for us and our customers. We believe that alternative dispute resolution will be a preferable option in most cases."

Christian said that a dispute which might take months to litigate, can be settled in a matter of weeks by binding arbitration. "Customers can have their legitimate grievances addressed without having to pay the high court costs and attorneys fees associated with litigation and the bank tends to be less exposed to unpredictably high damage awards."

Christian, a former California appellate court judge and advocate of alternative dispute resolution, said that organizations that have used binding arbitration have found that claimants tend to be more likely to be awarded compensation from binding arbitration than from litigation, but less likely to be awarded amounts significantly in excess of the actual damages they claim to have suffered. He said that binding arbitration has been used extensively by medical practitioners, construction companies and stock brokers, but is relatively new for banks. Banks of America began including binding arbitration in its commercial loan contracts four years ago, Christian said.

In addition to binding arbitration for individual complaints, Bank of America has instituted a procedure known as "judicial reference" for complaints made as class actions. Judicial reference is a long-standing, but seldom-used alternative dispute resolution procedure. If either party elects judicial reference in a class action, the judge refers the matter to a referee selected in the same way as for binding arbitration. After hearing the case, the

referee submits his decision to the trial judge, who is required to make it his judgment. After that, the normal judicial appeal process ensues.

"Judicial reference provides the same cost-saving and time-saving benefits for customers as binding arbitration, but it is also appealable, which we think is appropriate for class action complaints, since they are more likely to be complex and precedent-setting," Christian said.

ASSOCIATION OF BUSINESS TRIAL LAWYERS

abtl

NORTHERN CALIFORNIA

REPORT *Volume 3 No.1*

NOVEMBER '93

Mandatory Arbitration and Access to Justice

IN the March 1993 issue of the *ABTL Report*, Bank of America's Assistant General Counsel Arne D. Wagner defends the Bank's recent attempt to impose an alternative dispute resolution (ADR) requirement on its customers. It is reasonable to anticipate that other banks will follow suit. Wells Fargo Bank has already done so. This development bodes ill for consumers' ability to enforce their rights and safeguards under consumer protection statutes and would make equal access to justice dependent upon financial resources.

Bank ADR clauses typically mandate arbitration of individual disputes and judicial references for class actions and private attorney general cases that challenge business practices and seek relief for all affected customers. Such clauses attempt to deprive bank customers of access to the courts, particularly in class actions, and insulate banks against large jury verdicts. In the words of the architect of the Bank of America's ADR plan, Winslow Christian, this change will make the Bank "less exposed to unpredictably high damage awards." The purpose of these clauses plainly is to alter the rules governing dispute resolution to favor banks.

The advantages of arbitration and reference which Mr. Wagner enumerates may provide sound reasons why parties of equal bargaining power might choose to agree to resolve their disputes in the arbitral forum. Like sex, arbitration is fine between consenting adults. Imposing arbitration and judicial reference on unwilling consumers in order to reduce bank exposure is, however, unjust. Bank ADR clauses coerce parties of unequal bargaining strength into a forum which is perceived to be more hospitable to the financial institution.

The notion of mandating arbitration should have no place in our justice system. Arbitration as a method of resolving disputes is a creature of contract premised on the ability of parties of equal power to choose what method of resolving disputes will best serve their mutual needs. Arbitration arose in the context of labor relations, where unions and management negotiated a way of rapidly resolving disputes before a highly skilled labor arbitrator who is trusted by both sides in order to avoid strikes and labor unrest that jeopardized the pecuniary interests of both parties and the societal interest in industrial stabilization.

Thereafter, the use of arbitration to resolve disputes expanded. It was frequently negotiated at arm's length in commercial contracts between experienced and sophisticated business entities who desired to continue their business relationships. Part of those negotiations typically included a choice of which law would govern transactions between entities in different states or countries. In this commercial context, parties should be able to freely negotiate arbitration agreements in the expectation that they will be enforced. Requiring arbitration in the bank-

consumer context, however, distorts the process and raises serious issues of fairness.

The essence of arbitration is that it is consensual. The Federal Arbitration Act does not express any preference for arbitration, but simply for enforcing privately negotiated agreements to arbitrate, like any other contract, according to their terms. The consequences of arbitration are severe: even decisions that are wrong as a matter of fact or law and result in a manifest injustice cannot be overturned on appeal. *See Moncharsh v. Heily & Blase*, 3 Cal. 4th 1 (1992), and Code of Civil Procedure § 1280, *et seq.* The rationale for tolerating the possibility of an unfair or incorrect resolution is that parties who bargained to arbitrate should be held to it. This rationale requires a knowing consent to arbitrate. No system of resolving disputes can be considered fair if it can expose parties to manifest injustice without their knowing consent.

The Bank of America's method of communicating this change in contract terms is unlikely even to inform consumers, and does not seek (or obtain) their express consent. The Bank's notice of change of terms states:

> CHANGE OF TERMS NOTICE FOR BANKAMERICARD VISA, MASTERCARD, VISA GOLD, GOLD MASTERCARD, AND APOLLO ACCOUNTS
>
> Dispute Resolution – If you or we request, any controversy with us will be decided either by arbitration or reference. Controversies involving one account, or two or more accounts with at least one common owner, will be decided by arbitration under the Commercial Arbitration

> Rules of the American Arbitration Association. All other controversies will be decided by a reference under California Code of Civil Procedure § 638 and related sections. A reference who is an active attorney or retired judge will be appointed by the court after selection by the American Arbitration Association using its procedures for selecting arbitrators. The arbitration or reference will take the place of a trial before a judge and jury. (This is a new provision for Cardmember and Apollo Account Agreements. If you continue to use your account, this new provision will apply to all past and future transactions.)

The notice was inserted as a "stuffer" in the monthly statement to credit card holders and checking account customers. It is highly questionable whether customers even read such notices, which are included with other material such as a newsletter from the Bank and solicitations to purchase luggage, insurance and other goods or services.

Moreover, the notice does not say it is a contract and does not look like the Bank's standardized cardholder agreement. It has none of the indicia of a valid and binding contract. There is no manifestation of assent by consumers to be bound to these new terms. Instead, consumers are deemed to have consented to the arbitration and reference requirements if they use their credit cards. But continuing to make charges on a credit card cannot reasonably be construed to indicate assent to arbitration or judicial reference. Nor is this purported new contract term supported by consideration. There is no benefit conferred upon the cardholder, nor any detriment

suffered by the Bank. Instead, cardholders are being deprived by the Bank of substantial rights to unimpeded discovery, trial by judge or jury, and a court system funded by the taxpayers while getting nothing in return.

Finally, the terms of this new contract provision are not fully described. Nothing informs the Bank's customers that arbitration and reference will be costly or that discovery will be limited. Only those who obtain and read the rules of the American Arbitration Association will learn these important facts. Nor does the Bank explain that, as it interprets the ADR requirement, a referee's decision will automatically become the trial court's judgment. Only if the Bank's consumer customers happen to read a newspaper article that quoted Mr. Christian's press release of June 2, 1992, would they learn that the Bank construes its ADR clause to deny any judicial oversight of a referee's decision. Nor will consumers understand that case law specifies that arbitral decisions will be final and binding even if they are based on a misrepresentation of fact, apply the law incorrectly, or are unfair. Under these circumstances, no real agreement to arbitrate exists.

Even if there were a contract it would be adhesionary and unconscionable and therefore unenforceable. The ADR term is procedurally unconscionable because it is contained in a standardized form insert that is not negotiated but simply imposed by the party with greater bargaining power on a take-it-or-leave-it basis. Such a provision is not within the reasonable expectation of the consumer party. Moreover, the failure to describe many important features and consequences of arbitration and reference means that these will come as an unpleasant

surprise to consumers only after a dispute has arisen. Consumers who do not know what they are losing will have no reason to consider moving their accounts to banks that do not require arbitration and reference of disputes, even if they were financially able to do so. Moreover, particularly in today's economy, not every consumer is able to pay off existing balances or obtain credit elsewhere without doing so.

The arbitration and reference provisions are also substantively unconscionable because they deprive consumers of constitutionally guaranteed rights. Article 6, §§ 21 and 22 of the California Constitution vest the judicial power in duly appointed or elected judges and limit the functions of commissioners and referees to "subordinate judicial duties." Consistent with this constitutional mandate, the case law uniformly holds that consent of the parties is required before cases may be decided by persons other than judges. Without such consent, as numerous cases hold, the findings of commissioners or referees are advisory only. In *In Re Edgar M.*, 14 Cal.3d 727 (1975), the Supreme Court held that the adjudication of a juvenile court matter by a referee acting without any procedures for judicial review and without the parties' consent violates the constitutional limitation of a referee to "subordinate judicial duties." *Id.* at 735.

In *In Re Horton*, 54 Cal.3d 82 (1991), the Supreme Court again confirmed that the jurisdiction of a court commissioner, or any other temporary judge, to try cases depends on the parties' stipulation. Since the judicial power of the state is vested in the courts, a judgment entered by a court commissioner without a proper stipulation would be void.

In order to meet constitutional muster, a referee's decision, in the absence of a stipulation, must be advisory only and subject to judicial review. *The People v. Perrone C.*, 26 Cal.3d 49 (1979); *In Re John H.*, 21 Cal.3d 18 (1978). Therefore, the bank's attempt to make an arbitrator's or referee's findings "the judgment of the court" without the opportunity for a rehearing by a judge is an unconstitutional delegation of the judicial power.

These constitutional requirements are also reflected in the statutory scheme governing reference. Code of Civil Procedure § 638 requires a written stipulation for any reference. The case law consistently requires the written affirmation of both parties before a reference is permitted. *See e.g., In Re Hart's Estate,* 11 Cal.2d 89 (1938); *Fooshe v. Sunshine,* 96 Cal.App.2d 336 (1950).

Without consent, the reference of specific issues must be advisory only and the referee's decision becomes effective only after approval by the court. *Holt v. Kelly,* 20 Cal.3d 560 (1978). In *Bird v. Superior Court,* 112 Cal.App.3d 543 (1980), a reference exceeded statutory authority where the petitioner had not consented to reference, the issues referred were not those encompassed in Code of Civil Procedure § 639, and the referee's determination was not advisory only. *Accord, International Jet Ski Boating v. Superior Court,* 232 Cal.App.3d 112 (1991). Indeed, § 638 has been held to be constitutional specifically because the referee's report may be accepted or rejected by the court. *Sandoval v. Salazar,* 57 Cal.App. 756 (1922).

Finally, the constitutional guarantees of due process and equal protection contained in Article 1, § 7A also

require that the findings of a referee or other non-judicial officer be advisory only. *The People v. Perron C., supra. In the Matter of Gregory M.*, 68 Cal.App.3d 1085 (1977), held that due process and equal protection require a judge to review a referee's determinations, *Hebert v. Harn,* 133 Cal.App.3d 465 (1982), ruled that the statutory scheme for judicial arbitration, in order to be constitutional, required a right to *de novo* trial, by court or jury, as to law and facts. If judicial arbitration requires these constitutional safeguards, then non-judicial and non-consensual arbitration and reference must require no less.

Arbitration is particularly inadequate for resolving disputes about bank conduct because the typical arbitration clause seeks to avoid any discovery. Under California law, the right to discovery is deemed to be incorporated in agreements to arbitrate only for personal injury or wrongful death claims. In all other disputes, discovery is available only if the arbitration agreement expressly so provides. Since the typical bank ADR clause does not provide for discovery, banks would have to make available only those documents they intend to offer in support of their own claim. This would deprive consumers challenging the legality of bank charges of the evidence they need to prove their claims.

The substantive unconscionability of bank ADR clauses is exacerbated because it would greatly increase expense to consumers. Arbitration is inordinately expensive. The filing fees are $300 for a claim up to $25,000 (more than four times the $74 filing fee for Municipal Court) and $500 for a claim of $25,000 to $50,000 (almost three times the $182 fee for Superior Court). The maximum fee is $4,000 for a claim in excess of $5,000,000. If no

amount can be stated, the filing fee is $1,000, subject to adjustment. If injunctive relief is sought, the fee may be any sum deemed "appropriate" by AAA. In cases involving more than two parties, an additional 10% of the administrative fee is due for each additional party. The parties must also pay fees for processing the case: $150 per party for the first 180 days and $150 per party for every 90 days thereafter that the case is pending; $100 per day for each party for hearings, for postponing hearings, and for renting hearing rooms. In addition, the parties must compensate arbitrators. Requiring these substantial fees in order to challenge bank practices is particularly egregious because cardholders, as taxpayers, have already paid for the court systems so which banks would deny them access. They often cannot afford to pay a second time in order to challenge the bank's acts or practices.

Even if discovery is available in referenced disputes, it is still unconscionable to deprive consumers of access to the courts, which are established and supported by the state to afford forums for the rich and poor alike to present controversies at minimal cost to the litigants. Instead, a class of bank customers seeking to challenge unlawful conduct would be forced to bear the burden and expense of paying referees to handle law and motion issues, discovery disputes, and trial. Particularly in class actions and unlawful business practices cases, costs of reference could be many times more than litigation in court.

Bank ADR clauses would effectively insulate wrongful practices from any effective challenge. They would deprive customers of their constitutional rights without

their knowledge or consent and subject them to the risk of speedy injustice. Alternative dispute resolution mechanisms can serve a useful and important purpose where the parties agree to them, but to afford both the appearance and reality of fairness and justice, they must be based on consent, not on coercion.

Ms. Sturdevant is a partner in the firm of Sturdevant & Sturdevant.

❑

III

NATIONAL

ARBITRATION

FORUM

Monday, October 20, 1997

The Supreme Court has cleared the way and major American companies are moving all of their contracts to an arbitration basis as fast as possible. There is no reason for your clients to be exposed to the costs and risks of the jury system.

But all arbitration systems are not the same!

At the National Arbitration Forum:

Every issue is resolved according to the law!
Every decision is made by a legal professional!
Every award is limited to the amount claimed!
Every claim is decided on its own merits!

I have enclosed our complimentary Legal Memorandum, Arbitration & Class Actions in Financing. If we can answer more questions, give us a call at 800/474-2371!

Sincerely,

/s/ Edward C. Anderson, Esq.
Edward C. Anderson, Esq.
ECA:mkm

Enc

Legal Memorandum

DATE: October 1, 1997

TO:

FROM: Forum Counsel

SUBJECT: Arbitration & Class Actions in Financing

CONCLUSION: *Forum* Arbitrations may *not* be consolidated into class actions unless all parties consent.

AUTHORITIES: *Champ v. Siegel Trading Company*, 55 F.3d 269 (7th Cir. 1995); *Gammaro v. Thorp Discount*, 828 F. Supp. 673 (D. Minn. 1993)

In the court system, financing transactions are always at risk for Class Action treatment. Rule 23 of the Federal Rules of Civil Procedure (and the state equivalents) provides that claims will be consolidated if:

1. There are *common* questions of law or fact; and,
2. The claims of the "representative" are *typical* of those of the purported members of the class.

Most often, the claims of class action plaintiffs' lawyers are based on printed or computer-generated documents or standard procedure manuals, which leave little room to argue against "commonality" and "typicality". Even when "fraud" claims are made, which sometimes are more "personal", lenders run the risk that some court will find the requisite standard.

Faced with this reality, even spurious "class" claims will frequently be settled, since the costs and risks (even when discounted for probability) are so extreme that defense cannot be economically justified. Numerous commentators have argued that these cases are among the most prominent examples of abuse of the court system, but no change in these standards seems likely in the near term.

Since California banks began using arbitration in financing transactions in 1985, attention has been focused on the interplay between arbitration procedures and "class action" type consolidation of claims. In these and other cases, plaintiffs' lawyers have argued that, although a case will be decided outside the court system, Rule 23 standards should be applied to the "bundling" of claims. Defendants, for the most part, have resisted. Accordingly, the courts have addressed the issue in a variety of circumstances.

PRE-*SOUTHLAND* OPINIONS

Prior to the application of the Federal Arbitration Act to virtually all arbitration agreements by the U.S. Supreme Court (see opinions *Southland v. Keating*, 465 U.S. 1 (1985) through *Allied-Bruce Terminex v. Dobson*, 115 S.Ct. 834, (1995)), some courts relied on the express language of the parties to the contract, the arbitration rules, *or* state law to allow "consolidation" or "joinder" of multiple parties into a single arbitration. The leading case in this regard is *Compania Espanola de Petroleos v. Nereus Shipping*, 527 F.2d 966 (2d Cir. 1975). Although procedurally complex, this case stood for the proposition that, absent language or arbitration rules to the contrary, under state law, the court

had the authority to have the arbitrator(s) decide the claims of multiple parties, over the objection of one or more of the parties.

However, even prior to the "federalization" of arbitration law, the majority of federal courts had declined to adopt that standard. These courts held that, in cases in which the Federal Arbitration Act applied, the courts' authority was restricted to that granted by Section 4 of the Act. The court could only enforce the agreement of the parties, as reflected by the language of the agreement or the agreed rules of arbitration. *Weyerhauser v. Western Seas Shipping*, 743 F.2d 835 (9th Cir. 1984), cert. denied, 469 U.S. 1061 (1984); *Del Webb Construction v. Richardson*, 823 F.2d 145 (5th Cir. 1987); *Baesler v. Continental Grain*, 900 F. 2d 1193 (8th Cir. 1990). Unless the arbitration rules provided for class treatment, there would be no class action.

"FEDERALIZATION" OF ARBITRATION LAW

Beginning in 1985, the U.S. Supreme court began to hear a series of cases which, when resolved, would "federalize" the law regarding all arbitration agreements. In the first of these opinions, *Southland v. Keating, supra*, the court, for the first time, prohibited state legislatures, courts and regulators from applying higher standards to arbitration agreements than those applied to any other contract term, in a group of opinions culminating with the *Terminex* case, the court changed the law of arbitration to make it clear that the Federal Arbitration Act controlled almost all arbitrations.

These cases involved nearly every kind of agreement and every type of arbitration clause, including the consumer

contracts litigated in *Terminex*. The Supreme Court regularly expanded the reach of FAA authority to the full breadth of the Commerce clause. This result was reiterated in 1998, in *Doctor's Associates, Inc. v. Casarotto*, 116 S.Ct. 1652 (1995); where, after the Montana Supreme Court attempted to create a narrow exception to the blanket rule created by the Supreme Court, the Court held that arbitration agreements were always enforceable, except on the grounds that apply to all contract terms, such as fraud or unconscionability.

CLASS CLAIMS UNDER THE FAA

After the Supreme Court effectively applied the Federal Act to all arbitrations, few attempts have been made to claim "class" status for arbitrable claims. Those that have been asserted have been soundly rejected. Courts have addressed the issues squarely and have held that, where the arbitration rules did not specifically provide for arbitration on a class basis, under the FAA, the court may not order it. *Champ v. Siegel Trading Company*, 55 F.3d 269 (7th Cir. 1995); *Gammaro v. Thorp Discount*, 828 F. Supp. 673 (D. Minn. 1993); *McCarthy v. Providential Corp.* 1994 WL 387852 (N.D. Cal. 1994). Of note, *Gammaro* (app. dismissed, 15 F.3d 93 [8th Cir. 1994]), involved a consumer lending document which incorporated the Code of the National Arbitration Forum. Although the claims were both "common" and "typical", Forum Rule 19A was held to prohibit "class" treatment.

Courts have specifically held that signers of a mandatory arbitration agreement are excluded from a class action by

similarly situated plaintiffs (who had not signed the arbitration agreement). *Collins v. Int'l Dairy Queen, Inc.*, 169 F.R.D. 690 (M.D. Ga. 1997). Similarly, where claimed class members had signed an agreement to arbitrate, the class action would be enjoined and individual arbitrations would be ordered. *Doctors Associates v. Hollingsworth*, 949 F.Supp. 77 (D. Conn. 1996).

The current status of the law is that the FAA covers all but the most unusual arbitration agreements. Under the FAA, the courts' authority to consolidate claims in any way is severely limited and always limited by the arbitration rules.

Therefore:

> If the parties provide for "class" treatment, by agreement or by arbitration rules, the court will order such a procedure;
>
> If the rules prohibit such treatment, as the Forum Code does, the courts will *not* order "class" treatment:
>
> If the rules are silent, as are the AAA rules and others, the result could vary from state to state or Circuit to Circuit.

DECLARATION CONCERNING
DEBTOR'S SCHEDULES

DECLARATION UNDER PENALTY OF PERJURY
BY INDIVIDUAL DEBTOR

(NOT APPLICABLE)

DECLARATION UNDER PENALTY OF PERJURY
ON BEHALF OF CORPORATION OR PARTNERSHIP

I, the Secretary of the corporation / partnership named as debtor in this case, declare under penalty of perjury that I have read the following summary and schedules, consisting of 15 sheets plus the summary page, and that they are true and correct to the beast of my knowledge, information, and belief.

Date 1/5/94 Signature /s/ Edward C. Anderson
Edward C. Anderson
Secretary

Penalty for making a false statement or concealing property. Fine of up to $500,000 or imprisonment for up to 5 years or both. 18 U.S.C. § 152 and 3571.

None

[ ] d. List all financial institutions, creditors and other parties, including mercantile and trade agencies, to whom a financial statement was issued within the two years immediately preceding the commencement of this case by the debtor.

NAME AND ADDRESS DATE ISSUED

Norwest Bank Minnesota, N.A.

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18. INVENTORIES

None
[X] a. List the dates of the last two inventories taken of your property, the name of the person who supervised the taking of each inventory, and the dollar amount and basis of each inventory.

None
[X] b. List the name and address of the person having possession of the records of each of the two inventories reported in 18a., above.

---

19. Current Partners, Officers, Directors and Shareholders

None
[X] a. If the debtor is a partnership, list the nature and percentage of partnership interest of each member of the partnership.

None
[ ] b. If the debtor is a corporation, list all officers and directors of the corporation, and each stockholder who directly or indirectly owns, controls, or holds 5 percent or more of the voting securities of the corporation.

NAME AND ADDRESS	TITLE	NATURE AND PERCENTAGE OF STOCK OWNERSHIP
Edward C. Anderson	Director, officer, shareholder	4,500 shares
Roger S. Haydock	Director, shareholder	1,000 shares
Stephen P. Doyle	Director, office, shareholder	4,500 shares

---

20. Former partners, officers, directors and shareholders

None

[X] a. If the debtor is a partnership, list each member who withdrew from the partnership within one year immediately preceding the commencement of this case.

None

[ ] b. If the debtor is a corporation, list all officers, or directors whose relationship with the corporation terminated within one year immediately preceding the commencement of this case.

NAME AND ADDRESS	TITLE	DATE OF TERMINATION
Roger S. Haydock resigned as officer	Officer	11/1/93

UNITED STATES BANKRUPTCY COURT

District of Minnesota

In re: EQUILAW, INCORPORATED 41/1601581

Case No. ___

Chapter 7

List of Equity Security Holders

REGISTERED NAME OF HOLDER OF SECURITY LAST KNOWN ADDRESS OR PLACE OF BUSINESS	CLASS OF SECURITY	NUMBER REGISTERED	KIND OF INTEREST REGISTERER
Edward C. Anderson		4,500	Shareholder
Roger A. Haydock		1,000	Shareholder
Stephen Doyle		4,500	Shareholder

[1]STATE OF MINNESOTA DISTRICT COURT

COUNTY OF HENNEPIN FOURTH JUDICIAL DISTRICT

ITT Commercial Finance Corp.,

Plaintiff,

vs. Court File No. MX 92-3469

Wangerin, Inc., Ervin Wangerin, individually, and Sharon Wangerin,

Defendants.

****

DEPOSITION OF
EDWARD CHARLES ANDERSON, JR.

****

DATE TAKEN: 06/01/94 REPORTED BY: CINDY M. TRATTLES

* * *

[12] a '73.

Q And what is your present occupation?

A I'm the president of Pan Am Systems.

Q And how long have you been president of Pan Am Systems?

A Three years.

Q And when did that start, month and year?

A Early '91. I'm sorry I don't know the month.

Q And have you retained this position of president throughout that term?

A Yes.

Q Through today's date?

A Yes.

Q And who was your employer previous to that employment?

A ITT Consumer Financial Corporation.

Q And how long were you employed with them, what time period?

A About 1986 or '85 until the beginning of '91.

Q When you say beginning of 1991, is that when you went over to Pan Am?

A Yeah.

Q There was no gap period in there with another employer?

A No.

Q And what was your position with ITT Consumer Financial Corporation?

A Assistant general counsel.

Q Was that the same position you held throughout the time

* * *

[19] I referred to ITT's attorney had a conversation with Mr. Anderson's attorney, it was Ms. Gabrielle Hils; correct?

MS. HILS: Correct.

Q (By Mr. Hoverson) Going back to my earlier question, Mr. Anderson, when did you first become aware of National Arbitration Forum?

A Middle 1980's.

Q And how was it that you became aware of the National Arbitration Forum?

A Our office was conducting a nation-wide search for ADR providers. They were one of a dozen or so that were contacted.

Q Could you tell me what you mean by ADR?

A Alternative dispute resolution.

Q And when you say your office, do you mean ITT Commercial Finance or ITT Consumer?

A The general counsel's office of Consumer Financial Corporation.

Q And what were the circumstances that you first became aware of Equilaw, Inc.?

A The same way.

Q Could you describe for me the relationship between Equilaw, Inc., and National Arbitration Forum?

A National Arbitration Forum is a wholly-owned subsidiary of Equilaw, Incorporated. They're both corporations.

* * *

RAND/RP-327

Does ADR Really Save Money? The Jury's Still Out

Deborah R. Hensler

Reprinted from *The National Law Journal*

Does ADR Really Save Money? The Jury's Still Out

For those who hope ADR can reduce costs, the research is proving somewhat disappointing.

By Deborah R. Hensler
SPECIAL TO THE NATIONAL LAW JOURNAL

FACED WITH INCREASING caseloads and decreasing resources for handling their civil calendars, courts around the country look to alternative dispute resolution programs to reduce the public costs of civil case disposition. In the private sector, corporate counsel look to such programs to reduce their legal bills. But what's the evidence that ADR programs actually achieve cost savings for taxpayers and litigants? Ask a researcher who has been studying these programs and the answer may be "mixed," "ambiguous" or simply "not available."

The issue is not whether individual litigants can achieve cost savings by using ADR in specific disputes – the answer to that question is almost certainly yes. Rather, the question is whether courts or litigants can achieve aggregate cost savings – reductions that show up on the bottom line – by substituting ADR for litigation in large classes of disputes. The answer to this question is still largely unknown.

The most conclusive evidence on the effect of ADR on costs comes from studies of mandatory court-administered non-binding arbitration. These programs, which had been adopted by at least half the nation's state trial court systems, as well as a handful of federal districts, by the end of the 1980s,[1] have been subjected to numerous detailed studies by researchers at many institutions. The results many researchers have come up with are somewhat disappointing to those who had hoped such programs would reduce the public and private costs of civil case disposition.

Few Cases Diverted

Briefly, researchers have found that in most jurisdictions that adopt court-administered arbitration, too few cases are diverted from trial – the single most costly court "event" in the course of civil litigation – to balance the public costs of implementing an arbitration program.[2]

The problem is not that individual arbitration hearings are themselves very costly, or that very many parties reject the non-binding arbitration award and proceed to

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[1] S. Kellitz, G. Galls and R. Hanson, "State Adoption of Alternative Dispute Resolution: Where Is It Today?" 12 State Court J. 4 (1988).

[2] These studies have been conducted in state trial court jurisdictions in California, Colorado, Hawaii, New Jersey, North Carolina and Pennsylvania and in 10 federal district courts. For summaries of research results, see D. Hensler, "Court-Ordered Arbitration: An Alternative View." 1990 U. Chl. Leg. Forum 399 (1990), and R. MacCoun, E. Lind and T. Tyler, "Alternative Dispute Resolution in Trial and Appellate Courts." In Handbook of Psychology and the Law (1992).

trial. The typical hearing costs the court just a fraction of what it would cost to mount a trial, and in most jurisdictions only a tiny fraction of the cases that enter the arbitration program insist on a judge or jury trial.

But because these programs typically are put in place in jurisdictions in which only a small fraction of civil cases would go to trial absent arbitration, there is not much room for further reduction in the trial rate. Conversely, with so many cases in these jurisdictions poised to forgo trial – whether because of costs, delay or some other reason – a large pool of litigants and attorneys see in the arbitration program their only real opportunity to have their cases heard before a neutral third party.

In a number of studies,[3] researchers have found that once arbitration is put in place, cases that previously would have settled without any court intervention, or would even have been dropped without being formally joined, remain on the court calendar, only to settle just before or just after the arbitration hearing. As a result, court-annexed arbitration programs operate more as enhancements to the settlement process than as trial-diversion procedures. And the aggregate costs to the court of providing arbitration hearings to thousands of cases may off-set any public cost savings from reductions in the trial caseload.[4]

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[3] See, e.g., R. MacCoun, "Unintended Consequences of Court Arbitration: A Cautionary Tale From New Jersey," 14 Justice System J. 229 (1991), and E. Lind, "Arbitrating High Stakes Cases: An Evaluation of Court-Annexed Arbitration in a U.S. District Court" (1990).

[4] See, e.g., D. Hensler and E. Rolph, "Judicial Arbitration in California: The First Year" (1981).

Moreover, court-administered arbitration programs have had mixed success in reducing litigants' costs for legal fees and expenses. Probably because court-arbitrated cases usually do not proceed to trial, empirical data does not provide much support for opponents' claims that such programs will increase legal costs by adding another layer of procedure.

But research has shown that court-administered arbitration often does not reduce legal fees much either, unless the program rules operate to change the pretrial process in a significant fashion – for example, by strictly limiting discovery. Without such ancillary changes, whatever effects arbitration may have on lawyers' activities don't make much of a dent on the lawyers' bills.[5]

Interpreting the Findings

Two important lessons, with applicability beyond the court-administered arbitration context, emerge from these research findings.

First, inserting any new procedure in the litigation process – a process characterized by a combination of routinized "standard operating procedures" and complex strategic decision-making – is likely to produce unanticipated outcomes. Not only does the new procedure change the rules regarding a particular stage of the litigation process; it also changes myriad decisions made by the parties and their representatives, from the moment

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[5] See, e.g., R. MacCoun, "Unintended Consequences," and E. Lind, Arbitrating High Stakes Cases, supra, note 3.

they first consider filing a lawsuit through their final decision to resolve the dispute.

Court-administered arbitration proponents were seeking a low-cost means of diverting cases from trial. To their surprise, they created a quasi-adjudicative system that is so popular that it diverts cases from settlement – and commands enough support in the legal community that in many jurisdictions it is deemed worth implementing whether or not it reduces court costs.

Second, despite widespread concern about costs in the legal community and widespread acceptance of the "law and economics" model of settlement behavior – which asserts that parties will reach settlement whenever costs of proceeding to trial exceed the difference between the plaintiff's demand and the defendant's offer – litigants' and attorneys' disputing behavior are influenced by non-economic as well as economic factors.

Research on court-administered arbitration suggests that lay litigants – and many experienced litigants as well – place a value on having their cases heard that goes beyond whatever impact such a hearing might have on the ultimate monetary decision.[6] And, as every practitioner knows, many cases involve non-monetary, as well as monetary, stakes.

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[6] E. Lind, R. MacCoun, P. Ebener, W. Felstiner, D. Hensler, J. Resnik and T. Tyler. "In the Eye of the Beholder: Tort Litigants' Evaluations of Their Experiences in the Civil Justice System," 24 Law & Society Rev. 953 (1990).

Studies on Family Mediation

Family law mediation programs also have been the subject of extensive empirical research. The researchers' findings regarding the cost consequences of these programs parallel the findings for court-administered arbitration.[7]

Courts generally have been found to realize little cost savings from these programs, for three reasons. First, they require parties to appear in court before or after mediation. Second, mediation may encourage parties to review and revise child custody agreements over time, necessitating additional mediation hearings. Finally, properly implemented mediation programs require additional expenditures to pay trained mediators and program administrators.

The evidence of private cost savings is stronger for family law mediation than for court-administered arbitration; most researchers report some significant savings. But in this context, as with arbitration, there is some evidence that billing practices may dilute the impact that mediation might otherwise have on legal fees charged to clients.[8]

Much less is known about the cost consequences of other court-administered ADR programs – from the oldest of such programs, judicial settlement conferences, to

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[7] This research is summarized in J. Pearson, "Family Mediation," A Working Paper Prepared for the National Symposium on Court-Connected Dispute Resolution Research, Oct. 1993.

[8] Id.

the newest methods, early neutral evaluation, mandatory mediation of civil damage suits and summary jury trials.

There are few systematic studies of judicial settlement programs or summary jury trials. And no recent studies apply the comparative analytic design that is necessary to determine whether there is a difference, in costs or other outcomes, between resolving cases with or without such procedures in place. Analyses of early neutral evaluation and mandatory mediation of civil damage suits are ongoing, but have yet to produce conclusions relative to cost savings.

True Cost Impact

Logically, court-sponsored and privately initiated ADR programs can reduce the costs of civil litigation in three ways: by reducing the number of claims brought, thereby reducing the total court costs to process cases and the aggregate payouts by defendants; by reducing the expected value of claims – that is, the probability of a plaintiff victory multiplied by the average payout for successful claims; and by reducing legal fees and other transaction costs.

Court-instituted programs are directed only at the transaction-cost dimension. To obtain support for mandating the use of ADR in cases that are brought before them, many courts implicitly strive to design programs that will not change the pattern of outcomes in these cases. Nor are most court ADR programs intended to reduce the number of cases filed – although some, such as medical malpractice screening panels, are intended to eliminate

"frivolous" lawsuits. Indeed, if court ADR programs succeed in reducing transaction costs for civil cases – either directly, by providing lower-cost mechanisms for disposition or indirectly, by reducing congestion of the trial calendar – they may well induce increased filings.

Privately initiated programs, however, may have among their objectives reducing average payouts and thereby reducing claims filing. For example, in jurisdictions that bar the award of punitive damages in private binding arbitration, adopting arbitration limits the value of certain classes of cases, which may in turn make these cases less attractive to plaintiffs' attorneys. Similarly, substituting an expert arbitrator for a lay jury might be viewed as a means of reducing the value of certain claims, with questionable liability but high damages.

There is little systematic evidence of such types of cost reductions resulting from the institution of private ADR agreements. But a recent RAND Institute for Civil Justice study of the introduction of ADR in the banking industry found that the number of lender-liability claims against several major banks dropped dramatically after these banks instituted private binding arbitration.[9]

Claims Encouraged?

Conversely, private ADR programs, like their public counterparts, may increase the total costs of disputing if they encourage claims filing by providing a relatively low-cost means of dispute resolution.

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[9] E. Moller, E. Rolph and P. Ebener, "Private Dispute Resolution in the Banking Industry" (RAND 1993).

For example, studies of medical malpractice reform[10] have found that the inception of medical malpractice arbitration in certain states was accompanied by a rise in the total number of malpractice claims brought against health care providers. Although the average payout for all medical malpractice claims declined with the advent of these programs, the aggregate payout for malpractice claims increased, suggesting that arbitration encouraged the filing of meritorious smaller-value claims that individuals could not economically pursue in the trial system.[11]

Analyzing the effects of privately initiated ADR on parties' total costs is complicated by the potential for ADR to change parties' filing strategies. Analyzing private ADR's effects on transactions costs alone should be a simpler matter, but that research remains to be done.

It is clear that providers' fees to dispose of cases far exceed the typical court filing fee, particularly when commercial cases are involved.[12] The increasing enthusiasm in the business community for substituting private ADR for litigation suggests that parties believe the economic benefits of ADR outweigh these additional costs. But for parties who contemplate adopting or extending their use of private ADR, it would be useful if systematic evidence were available about the cost impact of using specific

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[10] See, e.g., P. Danzon, "New Evidence on the Frequency and Severity of Medical Malpractice Claims" (RAND 1986).

[11] Id.

[12] See R. Reuben, "The Dark Side of ADR." Calif. Lawyer 53 (Feb. 1994).

ADR procedures – arbitration, mediation, mini-trials and so on – for different types of disputes.

In the long run, whether public or private ADR programs achieve the promise of cost savings they hold out to courts and litigants will probably depend not so much on differences between which ADR approach is chosen or which entity provides the service but rather on how much they change patterns of disputing and lawyering. Parties who use litigation as an aggressive business tactic and lawyers who engage in excessive practices as a means of increasing their legal fees will find ways of pursuing their objectives through ADR procedures.

The evidence to date, although fragmentary and inconclusive, strongly suggests that ADR is not a magic bullet for reducing costs. ADR procedures may, however, provide a means of achieving such cost reductions for parties and attorneys who share that objective.

Dr. Hensler is director of the Institute for Civil Justice at the Rand Corp. in Santa Monica, Calif., and professor of law and social science at the University of Southern California Law Center.

III

NATIONAL ARBITRATION FORUM

January 14, 1999

Robert S. Banks, Jr.
KOIN Center, Suite 1450; 222 S.W. Columbia
Portland, OR 97201

Dear Robert:

A number of courts around the country have held that a properly-drafted arbitration clause in credit applications and agreements eliminates class actions and ensures that credit-related lawsuits will be directed to arbitration, not a jury trial.

All arbitration is not the same. The Forum is one of the two largest arbitration providers in the country for a reason.

- The forum is nationwide, with arbitrators in every federal judicial district.
- Forum arbitrators make decisions based on the law – not "equity" like some other arbitration providers. At a minimum, they have more than 15 years of legal experience and have arbitrated commercial, financial, and business disputes.
- The Forum's fees are reasonably priced to be accessible to consumers and businesses alike, making it the only system that truly works in consumer disputes.

We have a number of information resources on arbitration law and how arbitration will make a positive impact on the bottom

line. Contact Leslee Nelson at 800-474-2371 for a free information packet.

Regards,

/s/ C. Brown
Curtis D. Brown
V.P. and General Counsel

CDB/lkf

Enclosure

[The Washington Post]

BUSINESS

WEDNESDAY, MARCH 1, 2000

Win Some, Lose Rarely?

Arbitration Forum's Rulings Called One-Sided

By CAROLINE E. MAYER
Washington Post Staff Writer

Like many banks car dealers and retailers, First USA N.A., the nation's second-largest issuer of credit cards, no longer permits its customers to sue it in court. Instead, any disputes must be resolved through arbitration by a firm chosen by First USA.

Businesses such a First USA say that for everyone involved, arbitratior is faster, more efficient and cheaper than litigation. But arbitration may also mean that the company wins most of the time – at least according to data recently submitted in a lawsuit in an Alabama state court.

The data, disclosed last month by First USA in a class-action lawsuit challenging mandatory arbitration, show that not only had the company sought arbitration far more often than consumers, it has also won in 99.6 percent of the cases that went all the way to an arbitrator.

First USA's experience in the two years since it imposed its arbitration requirement is likely to become a focal point in the debate over the arbitration rules contained in many consumer contracts. Arbitration has for

years been a means to resolve disputes between businesses, but increasingly companies are including arbitration clauses in consumer agreements and employment contracts. In First USA's case, consumers were notified by a fine-print insert in their monthly bills that by using their cards, they agreed to take disputes to arbitration.

Dozens of lawsuits around the country are contesting the arbitration rules, with mixed results. At least three of these suits also question the impartiality of the arbitration firm selected by First USA and many other credit-card firms and retailers, such as American Express and Best Buy.

These suits contend that the firm, the National Arbitration Forum, is so financially dependent on the banking industry that it can seldom afford to rule against companies. Furthermore, they say the forum's own marketing materials, promising a "positive impact on the bottom line," suggest that the organization is inherently biased against consumers.

A spokesman for Bank One, which owns First USA, declined to discuss the suits, saying the company doesn't comment on pending litigation.

Edward Anderson, managing director of the forum, dismissed the allegations in the lawsuits, saying, "We are impartial, and more importantly our arbitrators – former judges, lawyers and law professors – are impartial." Anderson said the lawsuits "are merely an attempt by trial lawyers to find a way to avoid arbitration" so they can continue to collect high fees in big class-action court cases. In arbitration, high lawyer fees are unlikely

because almost all involve individual claims for relatively small amounts.

The controversy over arbitration will get attention today in Congress. The Senate Judiciary subcommittee on administrative oversight and the courts will hold a hearing on the growing number of contracts that require employees, businesses and consumers to agree, in advance of any disputes, to give up their rights to sue and submit all future disputes to arbitration.

Subcommittee Chairman Charles E. Grassley (R-Iowa) said he is a proponent of arbitration as a means of unclogging the courts. But he said he wants to "make suer consumer interests are protected in the process and that the arbitration is being conducted in a fair way."

Rep. Luis V. Gutierrez (D-Ill.) introduced a bill in the House last year that would bar mandatory-arbitration provisions in consumer contracts, and Sen. Russell Feingold (D-Wis.) plans to introduce similar legislation. He tried to attach such a provision to the bankruptcy legislation recently passed by the Senate, but he dropped the attempt in exchange for the subcommittee hearing.

Since First USA implemented its arbitration clause in early 1998, it has filed 51,622 claims against consumers with the forum. In the cases that First USA filed, the forum has made 19,705 awards. First USA prevailed in 19,618, card members in 87. (Of the remaining cases, First USA said more than 28,000 had "expired" because the customers had not been notified in a timely fashion as is required by the forum's rules. More than 3,600 cases are still pending.)

Meanwhile, only four consumers have filed cases against First USA with the forum. In two of these four cases, the arbitrators made awards against First USA; one case was settled, and another is still pending.

The fact that the company sends cases to arbitration far more often than consumers is a function of economics, say consumers' lawyers. It costs $49 to file a complaint with the forum, an amount that may be reasonable to big businesses trying to collect large unpaid debts. But for a consumer challenging late fees of about $29 or high interest rates, the filing fee may not be worthwhile. In the past, these consumers might have joined a class-action suit to fight the companies. Costs for such suits are minimal because most lawyers take them on a contingency basis.

While Bank One spokesman Thomas Kelly declined to talk about the lawsuits, he said "the overwhelming majority" of cases that First USA filed at the forum "are claims against customers who are more than six months delinquent" in paying their bills.

To the forum's Anderson, the figures are meaningless because First USA would probably have had a similar success rate had it pursued the same cases in court. Anderson said creditors win about 98 percent of collection actions brought against debtors in federal courts. While declining to discuss the specific numbers provided by First USA, saying they were confidential, Anderson said "expired" cases should be counted as victories for consumers.

As companies have adopted these clauses, business has grown for the forum, a private firm where 20,000

cases were filed last year, up from 16,000 the year before, according to Anderson. It is the second-largest arbitration firm in the country, behind the nonprofit American Arbitration Association, which handled more than 140,000 cases last year. Officials at the American Arbitration Association said almost all of those were commercial cases that didn't involve consumers. In contrast, arbitration industry experts say, the forum's business involves more corporate-consumer disputes, in large part because of the company's aggressive marketing.

The forum's marketing letters are an issue in at least three lawsuits that question its impartiality. In one letter, Anderson wrote: "There is no reason for your clients to be exposed to the costs and risks of the jury system."

Another letter urged lawyers to contact the forum to see "how arbitration will make a positive impact on the bottom line."

A coalition of public interest groups that includes the Trial Lawyers for Public Justice, AARP, the National Association of Consumer Advocates and the Association of Trial Lawyers argues that these letters suggest that the forum will take the companies' side.

"If a court were to solicit business from a party that might come before it with strong hints that the solicited party would get a good deal in her or his courtroom, there is no doubt that this would be improper and sanctionable behavior," the group said in a friend-of-the-court brief filed in a case challenging First USA's arbitration clauses.

Anderson said the letters simply state the law and economics of arbitration. "The letters say you save money through arbitration, and that's true – all parties save money. . . . There's nothing secret about the way we market. We market to everybody – to attorneys general, consumer protection administrators, anybody who will listen," he said.

Britton D. Monts, a Dallas Lawyer who has filed a class-action suit against First USA in a federal court in Texas alleging improper late fees, said evidence collected in his lawsuit shows that "virtually all" of the forum's income comes from First USA collection fees, making its business vital to the future of the company.

Anderson said that is a "complete fabrication" and "there's no evidence that it's true." He declined to disclose specific financial data, saying the forum was a privately held company. The company did submit its financial records to the federal court in Dallas, after a court order, but on the condition that they be kept confidential.

First USA papers filed in the Dallas case show that the company paid the forum $5.3 million between January 1998 and November 1999. "Without question, loss of First USA's business would result in a major financial blow to [the forum] and is the kind of loss [the forum] would necessarily have to avoid," Monts said. "The idea of a private court being financially dependent on a litigant appearing before it is an insult to the integrity of our justice system."

Alan Kaplinsky, a Philadelphia lawyer who represents several financial institutions and is a strong advocate of mandatory-arbitration clauses, said such charges are unfair. "The forum has put together an extensive list of experienced, highly reputable arbitrators," he said. "To suggest that the forum would basically become partial because of the First USA fees impugns the integrity of their arbitrators."

ADRO
adrworld.com

EC Says ADR for E-Commerce Disputes Should Not Be Compulsory

June 21, 2000
By Tony Kreindler, ADRWorld.com

The use of online alternative disputes resolution systems by e-commerce companies to settle complaints over transactions should not preclude consumers from exercising their right to go to court, according to comments filed by the European Commission with the U.S. Federal Trade Commission on June 19.

According to the EC, the use of any "exhaustion principles" – requirements for a consumer to exhaust all ADR remedies before being allowed to start a court action – could lead to protracted disputes and undermine consumer confidence in dispute resolution systems. "In addition, in many jurisdictions such compulsion would be viewed as unfair," the EC said in its comments. "By producing an agreement that gives with one hand and takes away from another is unlikely to fill a consumer with confidence."

The EC filed its comments in response to a recent workshop sponsored by the FTC and Department of Commerce to explore the use of online ADR mechanisms to foster consumer confidence in e-commerce by providing a more efficient and cost-effective way to settle disputes. The agencies, as well as business representatives and consumer advocates, hope that online ADR mechanisms can solve the jurisdictional problems and complexities of resolving disputes over cross-border transactions through

traditional legal channels. One issue that was discussed at the workshop and that remains a subject of debate is whether consumers and businesses should be bound to use ADR systems if a dispute arises.

According to the EC's comments, "Existing legal frameworks ensure a legal safety net which will underpin consumer confidence in shopping on-line cross-border," and the reassurances provided by those frameworks are particularly important to e-commerce because it is still in the embryonic stage. "But ADR and legal redress are two separate issues," the EC said, and access to legal redress "should not be made conditional on the use or even the exhaustion of the possibilities of the former." The EC added that an effective and fair ADR system that gives consumers confidence will be used without the need for compulsion.

Role of Government

In its comments, the EC reiterated its long-standing position that public authorities should not develop ADR systems or codes of conduct themselves, but instead pursue a partnership with all stakeholders. "Industry should be encouraged not just to develop ADRs in isolation, but to create a package of measures including the trustmarks and codes of conduct," the EC said, and public authorities "must act as honest brokers in this process allowing standards to be established by consensus through the exchange and development of these stakeholders experience. The EC added that it has just begun such a "co-

regulation" process to address the need for general principles covering codes of conduct and accreditation, as well as principles for mediation and conciliation.

The EC also reiterated its position that a recognizable seal or trustmark for e-tailers who adhere to a code of conduct "will play an important role" by providing consumers with a reference point and serving as an effective tool for enforcement. Codes of conduct should encourage a market environment that rewards best business practices, and they should include effective monitoring, sanctions and consumer complaint mechanisms.

The FTC and Commerce Department are accepting public comment on the use of online ADR for consumer disputes until June 29. For more information and full text of comments received visit www.ecommerce.gov/adr on the World Wide Web.

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